



Consolidation cooking

With gas supply bottlenecks to ease and gas penetration to improve, we see the ingredients coming together for a key investment theme for 2011 and beyond: large project M&A and industry consolidation. After years of development, many downstream projects in second-tier cities with immediate piped gas sources and good economics have been taken. The most appetising future opportunities are likely to come from medium- to large-sized projects and new projects along W-to-E pipelines II & III and other new gas sources. We expect strong competition for these from well-connected SOEs. We see increased potential for industry consolidation over the next five years, during which large companies with strong balance sheets, better access to gas sources, and strong government support should outperform. Our top picks, CR Gas and Beijing Enterprises, will likely be major consolidators, we believe. We also like Kunlun Energy, for its hybrid business model and potential asset injections from its parent. Our BUY ratings also flow from strong earnings outlooks over the next 3 years: a 30.7% CAGR for CR Gas, 21.4% for Beijing Enterprises and 44.9% for Kunlun Energy. We see a neutral impact from potential gas price reform (dollar margin maintained) and believe gas connection fees will stay in one form or another.

- ① Remain Bullish on China's gas distribution sector
- ② 12th FYP – Government's supportive stance on gas demand
- ③ Prepare for industry consolidation in the long run
- ④ BUY CR Gas, Beijing Enterprises and Kunlun Energy

Nomura Anchor Reports examine the key themes and value drivers that underpin our sector views and stock recommendations for the next 6 to 12 months.

Any authors named on this report are research analysts unless otherwise indicated.
See the important disclosures and analyst certifications on pages 133 to 136.

Stocks for action

We prefer CR Gas and BJE for their visible growth story, long-term market leader and consolidator positions in the gas distribution sector.

| Stock | Ticker | Rating | Price | Price target |
|-------------------------|---------|----------|-------|--------------|
| Pure China plays | | | | |
| CR Gas | 1193 HK | BUY | 11.72 | 14.80 |
| Beijing Enterprises | 392 HK | BUY | 52.05 | 70.50 |
| Kunlun Energy | 135 HK | BUY | 10.08 | 13.50 |
| ENN Energy | 2688 HK | NEUTRAL | 25.35 | 24.10 |
| Towngas China | 1083 HK | NEUTRAL↑ | 3.56 | 3.40 |
| China Gas | 384 HK | REDUCE↓ | 4.42 | 3.70 |
| Indirect plays | | | | |
| HK and China Gas | 3 HK | REDUCE | 19.02 | 16.50 |

Note: local currency; pricing as of 2 November, 2010
↑ Upgrade from Reduce to Neutral; ↓ Downgrade from Neutral

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Action

We are Bullish given stable dollar margin and strong pent-up gas demand. We expect more gas supply to flow to China to meet the strong demand, driven by the 12th FYP. Any potential price reform should be neutral to gas distributors. More acquisition and cooperation will happen but in the long run, industry consolidation is inevitable. CR Gas and Beijing Enterprises are the likely winners, in our view.

Catalysts

M&A, gas pricing reform and the government's supportive policies on gas usage.

Anchor themes

We are upbeat on China's gas distribution sector, considering: 1) favourable government policies; 2) robust demand growth underpinned by the transition to clean and low-cost energy; 3) stable margins attributable to strong cost pass-through capability; and 4) potential upside from the new energy initiatives.

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① Remain Bullish on China's gas distribution sector

On assumption of coverage, we reaffirm our Bullish view on China's gas distribution sector as we expect: 1) substituted demand to support clean and low cost energy; 2) gas supply outweighing demand in 2012F, we estimate; 3) strong 20%-plus pa gas demand growth; 4) neutral impact from potential gas price reforms (dollar margin maintained); and 5) sustainable gas connection fees.

② 12th FYP – Government's supportive stance on gas demand

With the government's targets to reduce carbon emissions by 40-45% by 2020, as depicted under the 12th Five-Year Plan (FYP), China plans to raise the natural gas proportion in the primary energy mix from 3.9% in 2009 to 8.3% in 2015F, representing a demand CAGR of 19.4%. This shows the government's supportive stance in utilizing natural gas as a major clean energy source.

③ Prepare for industry consolidation in the long run

After 10 years of development, the majority of downstream projects at second-tier cities with immediate piped gas sources and good economics have been taken. We expect opportunities to come from medium- to large-sized projects and new projects along W-to-E pipelines II & III and other new gas sources; these are expected to see strong competition from well-connected SOEs. We see increased potential of industry consolidation over the next five years, during which large size companies with strong balance sheets, better access to gas sources and strong government support should outperform, in our view.

④ BUY CR Gas, Beijing Enterprises and Kunlun Energy

CR Gas and Beijing Enterprises will be major consolidators, in our view. CR Gas and Beijing Enterprises are our top picks. We also like Kunlun Energy for its hybrid (E&P and natural gas) business model and potential asset injections from parent. We downgrade China Gas to REDUCE, due to margin volatility on its LPG business, limited growth from its piped gas business and options dilution risk. We upgrade Towngas China to NEUTRAL due to fair valuation. HK & China Gas remains a REDUCE on demanding valuation. ENN is a NEUTRAL given rising new project risks. We also provide updates on 12 not rated listed gas plays in China.

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Executive summary

Road to consolidation

We have been Bullish on China's gas distribution sector since 2008 (report "Sweet when ripe", dated 27 November 2008). In the last report, we highlighted our preference for companies in the "harvest stage" financially – completed acquisition and fundraising, and showing robust earnings growth, high earnings visibility, low capex, positive free cashflow, improving ROIC and defensive yield. Despite impressive share price performances so far (up 2-3x vs HSCEI of 0.62x over 2009-YTD), we expect more upside to be awarded from the next investment theme "industry consolidation". After almost 10 years of privatization and development, the majority of downstream projects at second-tier cities with immediate piped gas sources and good economics have been taken. Thus, we expect opportunities to come from medium to large size projects at first-tier cities and new projects along West to East (W-to-E) pipelines II & III and other upcoming new gas sources. We expect these to see strong competition from well-connected SOEs. Also, we see increased potential for industry consolidation at second-tier cities over the next five years, during which large size companies with strong balance sheets, better access to upstream gas sources and strong government support should outperform. We highlight Beijing Enterprises (BJE), China Resources Gas (CR Gas) and Kunlun Energy as the potential winners of this investment theme.

Positive on China's gas distribution sector

We remain fundamentally **positive** on the Chinese Gas Distribution sector, due to: 1) low cost clean energy, 2) rising gas supplies, 3) strong pass-through mechanism and 4) sustainable gas pipeline connection fees.

A low cost clean energy

Natural gas is a clean and inexpensive source of energy, with stable chemical performance. However, China's natural gas industry is still in the infancy stage, contributing only 3.9% of primary energy usage in 2009, well below the world's average of 23.8%, according to the BP Statistical Review. Also, natural gas prices in China are at a 30% discount to those of electricity, oil and diesel. Therefore, we expect persistent strong gas consumption to come from substitution demand. Also, this industry is seen as being strategically important in reducing the country's reliance on coal and imported oil.

More gas supply flowing to China

China has experienced strong gas demand over the past few years, but gas supply shortages have limited its gas industry development. However, with more gas pipelines (such as W-to-E pipelines II & III, Sichuan-to-East, etc.) coming on-stream in the next couple of years, together with increasing LNG supplies, we expect sufficient gas supply to meet its strong gas demand growth going forward. For 2010F, we estimate total gas supply of 98bcm, with the majority coming from domestic production. For 2015F and 2020F, we expect total gas supply to reach 252bcm and 359bcm, respectively, with a significant proportion coming from imports. Based on our estimates, China's gas supply will outweigh gas demand in 2012F.

We expect gas supply to outweigh demand by 2012F

Strong pass-through mechanism

Currently, wellhead gas prices in China are much lower than international gas prices and those of other renewable energy, resulting in gas demand outweighing gas supply. With more new gas supplies coming from imports, such as central Asia and Russia, we expect wellhead gas prices in China to come under pressure. Currently, the industry players are expecting the Chinese government to implement a gas pricing reform in the near future, such as "one province, one price", unification of residential and non-residential prices, etc. We do not expect any significant gas pricing reform to be implemented in the near term. However, we continue to believe gas tariff hikes will follow increases in wellhead prices so that downstream players are able to pass through the increased cost to customers and at least maintain their dollar margins.

At least the dollar margin is expected to be maintained for any gas pricing reform

Sustainable gas pipeline connection fees

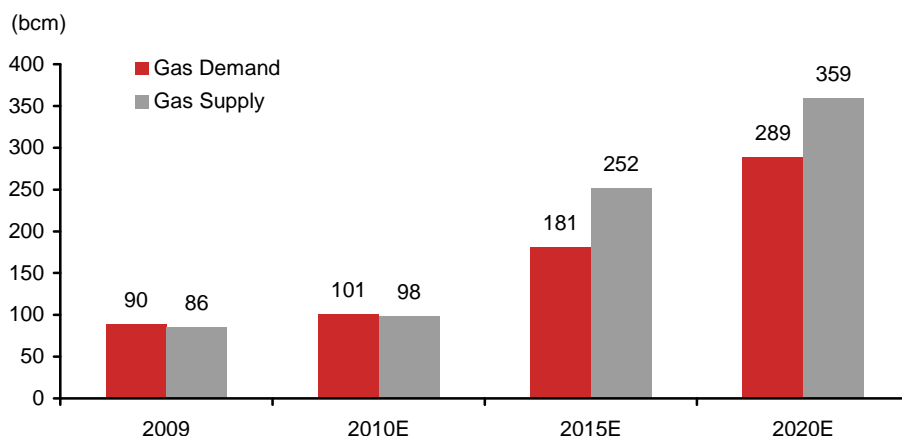
We believe gas pipeline connection fees will remain stable in the near term to motivate city gas distributors to increase their gas penetration rates in China, since the average penetration rate in China is only 20% versus a matured Chinese city of over 80%. However, we believe the proportion of gas pipeline connection fees in the revenue structure will likely drop gradually. In our opinion, once the penetration rate reaches about 50%, the Chinese government is likely to abolish the gas pipeline connection fee system. In our model, we have assumed that by 2017F, about half of China's gas pipeline connection fees would be abolished.

12th Five-Year Plan (FYP) to support growth

We expect the Chinese government to support the usage of more natural gas in the near term. Under the 12th FYP, the government targets to reduce carbon emissions by 40-45% by 2020. It also plans to increase the natural gas proportion in the primary energy mix from 3.9% in 2009 to 8.3% in 2015, implying a CAGR of 19.4%. Although we are not optimistic about the targets, we expect strong support from the government to raise the country's gas usage in the near term. We estimate China will enjoy a gas demand CAGR of 11.3% over 2009-20F, with gas consumption reaching 181bcm by 2015F and 289bcm by 2020F. We are confident of China achieving our base-case scenario, with upside potential.

The 12th FYP raises the natural gas proportion in the primary energy mix from 3.9% in 2009 to 8.3% in 2015

Exhibit 1. China: Gas supply > gas demand in the short run



Source: CEIC, Nomura estimates

Road to consolidation

Phase I: Project acquisitions/ cooperation

The China gas distribution sector is under a project-acquisition / cooperation phase (Phase I), including joint bidding for new projects, joint operation of some midstream pipeline projects and compressed natural gas (CNG) business. Currently, there are about 70-80 medium and large city gas projects that are in the hands of local governments. We believe in Phase I, these projects will gradually be acquired by city gas companies and we expect many acquisitions for the next five years. We do not expect any large scale M&A activities any time soon, as the industry is still facing a low penetration rate. Nonetheless, with China's gas supply increasing gradually and gas distributors' margins staying stable, we expect city gas companies to witness 20%-plus bottom-line growth, still a decent return for distributors, in our view.

In our opinion, all gas distributors in China will actively look to secure new projects in the next few years. However, we believe CR Gas has the biggest opportunity to secure more projects, including medium to large size projects. Leveraging the "China Resources" brand name, the company can acquire directly from third parties to grow its portfolio, or for medium to large size projects (or unprofitable projects), its parent,

We expect CR Gas, BJE and Kunlun Energy to secure medium to large sized projects in Phase I

CR Holdings, can acquire, then improve or restructure the assets before injecting (likely at a discount) them into CR Gas. We also believe Kunlun Energy can benefit from potential asset injections from PetroChina, which has intention to access China's natural gas downstream market. BJE is also another potential beneficiary, in our opinion, given its plan to expand outside of Beijing with the help of its SOE status and strong cashflow.

Phase II: Road to consolidation

Industry consolidation is inevitable in the long run, in our view. We believe any consolidation will take at least five years to happen, during which we believe:

1) organic growth will subside; 2) fewer projects will be made available in the market; 3) the penetration rate will likely reach about 40-50%, leading to the potential abolition of the pipeline connection fee; 4) gas supply and demand may reach an equilibrium, with potential deregulation for gas prices (both upstream and downstream) and 5) the government intends to have only one operator per province, for reasons of ease of control and economies of scale.

By then, small players would likely not only lose contributions from the pipeline connection fee system, but also bargaining power to obtain low gas prices to remain profitable. At the same time, large gas distributors would seek growth through M&A with small players. As such, we believe size does matter in the long term, as only big players have the means to survive in the market. Among our coverage universe, we believe CR Gas, BJE and Kunlun Energy possess the greatest potential to be major acquirers and survivors in the market, since: 1) we expect them to benefit in near-term M&A activities to grow their size; 2) their SOE status should provide greater bargaining power in negotiating for more preferential gas prices; and 3) their strong balance sheet and cashflow provide more flexibility for consolidation.

We expect CR Gas, BJE and Kunlun Energy to be acquirers and survivors in the markets in long term

Macro headwinds

Concerned about CPI

We believe the Chinese government will continue to allow wellhead costs to pass through to end users. Given the country's mild inflation (Nomura estimates 3.6% in 2011F and 4% in 2012F) and the government's supportive stance towards efficient use of natural gas, we see no difficulty in passing on the cost, although a time lag is expected. Gas distributors' absolute margins look sustainable but the percentage may see a dip. In the longer term, the automatic pass-through mechanism is likely to take place, which minimizes margin squeeze by gas distributors.

Limited impact from macro risks

Slowing GDP and industrial production growth

With natural gas shortages over the past few years and competitiveness of natural gas over other types of energy, the sector has been constrained by gas supply and many industrial customers are awaiting pipeline connections. Therefore, China's gas distribution sector is a "supply-pulled" rather than a "demand-pulled" sector, and any slowdown in GDP or industrial production should not affect distributors' gas sales volume growth materially, in our view. Indeed, the substantial increase in gas supply since this year has allowed distributors to connect and sell more gas to industrial users.

Interest rate hikes

The recent interest rate hike has raised concerns of increased financial burden in the sector. Generally, our assumption has already factored in a rising interest rate environment. Among our coverage universe, except for China Gas which we expect to face the biggest adverse impact (a 1% interest rate hike would cause its FY11F net profit to drop 11%, according to our sensitivity analysis), the impact on other gas distributors is immaterial, according to our estimates.

The potential winners and losers are ...

With this report, we assume coverage of CR Gas, Beijing Enterprises, Kunlun Energy, ENN Energy, Towngas China, China Gas and HK & China Gas due to the transfer of analyst coverage.

We believe the key investment theme in 2011F and on a longer-term basis should relate to sustainable growth momentum, from the short-term acquisition story to being a market leader/consolidator in the long term. Across the gas distribution universe, we favour CR Gas, Beijing Enterprises and Kunlun Energy. We have REDUCE ratings on China Gas and HK and China Gas. We are NEUTRAL on ENN Energy and Towngas China.

BUY – CR Gas, Beijing Enterprises and Kunlun Energy

NEUTRAL – ENN Energy and Towngas China

REDUCE – China Gas and HK & China Gas

CR Gas (1193 HK, BUY): Long-term market leader

We like CR Gas for its short-term value-accretive parent's assets injection and direct acquisition through leveraging its parent's strong platform. We are also positive that the company would be a consolidator in the long run. We believe current share prices have understated its existing assets value and neglected the potential value-accretive asset injection. We maintain BUY with price target unchanged at HK\$14.8.

Beijing Enterprises (392 HK, BUY): Quality assets; undemanding valuation

We like the company for its quality assets portfolio, which combines businesses with both stable (gas and brewery) and high (water) growth. Similar to CR Gas, we believe the company will be a consolidator in the long run. We reaffirm our BUY rating with a revised price target of HK\$70.5 (from HK\$60.9).

Kunlun Energy (135 HK, BUY): Running on two legs

Supported by PetroChina's rich gas resources, Kunlun Energy is well positioned to capture China's robust natural gas demand growth. We forecast a strong earnings CAGR of 50% over FY09-12F, driven by strong natural gas volumes and supported by E&P. We have a BUY rating on Kunlun Energy and a price target of HK\$13.5.

China Gas (384 HK, REDUCE): Weighed down by LPG business

We believe: 1) the LPG business continues to drag down China Gas' overall profitability and raises its risk profile; 2) limited growth potential from small cities; and 3) option dilution and sensitive to interest rate hikes also limit shareholders' return. With weak fundamentals ahead, we downgrade China Gas to REDUCE (from Neutral), with a revised price target of HK\$3.70 (from HK\$4.30).

HK and China Gas (3 HK, REDUCE): Valuation remains a concern

We find HKCG unattractive on valuations. HKCG is trading at 25.8x FY11F P/E, vs 19.6x for pure China gas distributors and 17.1x for HK utilities, which we think is unjustified because of HKCG's stagnant HK business, declining investment income, tail-ending property earnings and slowing China growth. We reaffirm our REDUCE rating with price target unchanged at HK\$16.5.

NEUTRAL-rated stocks

We maintain NEUTRAL on ENN Energy (2688.HK), upon balancing its growth potential from the gas distribution business and higher risks involved in its new business and overseas projects. However, we lift our price target to HK\$24.1 from HK\$21.30.

Despite the lack of near-term catalysts, we upgrade Towngas China (1083.HK) to NEUTRAL (from Reduce) solely due to fair valuations at current share levels. We lift our price target from HK\$2.20 to HK\$3.40.

Exhibit 2. Valuation comparison I

| Company Name | Ticker | Rating | Trading Currency | Share Price | Price Target | Upside / Downside | Mkt Cap USD mn | P/E | | | | P/B | | | | EV/EBITDA | | | | ROE | | | | ROA | | | |
|---------------------|---------|---------|------------------|-------------|--------------|-------------------|----------------|-------|------|------|------|------|------|-----|-----|-----------|------|------|------|--------|-------|-------|-------|--------|-------|-------|-------|
| | | | | | | | | 09 | 10F | 11F | 12F | 09 | 10F | 11F | 12F | 09 | 10F | 11F | 12F | 09 | 10F | 11F | 12F | 09 | 10F | 11F | 12F |
| CR Gas | 1193 HK | BUY | HKD | 11.72 | 14.80 | 26.3% | 2,138 | 37.4 | 25.6 | 19.5 | 16.7 | 16.1 | 3.5 | 3.1 | 2.7 | 28.0 | 13.7 | 9.0 | 7.5 | 27.2% | 20.8% | 16.8% | 17.1% | 6.8% | 6.2% | 6.5% | 6.4% |
| Beijing Enterprises | 392 HK | BUY | HKD | 52.05 | 70.50 | 35.4% | 7,637 | 24.7 | 19.5 | 16.7 | 13.8 | 1.9 | 1.8 | 1.6 | 1.5 | 11.4 | 10.0 | 8.6 | 7.5 | 7.9% | 9.3% | 9.8% | 10.8% | 4.3% | 4.9% | 5.3% | 5.9% |
| Kunlun Energy | 135 HK | BUY | HKD | 10.08 | 13.50 | 33.9% | 6,442 | 38.2 | 19.5 | 15.7 | 12.4 | 3.5 | 3.0 | 2.6 | 2.3 | 18.3 | 9.0 | 7.6 | 5.8 | 9.6% | 16.7% | 18.0% | 19.8% | 9.2% | 15.7% | 14.9% | 15.0% |
| ENN Energy | 2688 HK | NEUTRAL | HKD | 25.35 | 24.10 | -4.9% | 3,434 | 29.6 | 22.7 | 18.4 | 16.7 | 4.5 | 3.8 | 3.1 | 2.8 | 12.5 | 10.6 | 8.1 | 6.7 | 17.0% | 18.3% | 18.8% | 17.6% | 5.1% | 5.6% | 5.6% | 5.1% |
| Towngas China | 1083 HK | NEUTRAL | HKD | 3.56 | 3.40 | -4.5% | 899 | 26.3 | 22.3 | 18.5 | 15.2 | 1.1 | 1.0 | 1.0 | 0.9 | 15.7 | 12.1 | 9.8 | 8.3 | 3.8% | 4.4% | 5.1% | 5.9% | 2.4% | 2.9% | 3.4% | 4.0% |
| China Gas* | 384 HK | REDUCE | HKD | 4.42 | 3.70 | -16.3% | 1,915 | 142.1 | 16.9 | 22.8 | 19.1 | 4.6 | 3.6 | 2.4 | 2.2 | 22.8 | 15.6 | 10.1 | 7.9 | 3.3% | 23.8% | 12.3% | 12.0% | 0.7% | 4.3% | 3.1% | 3.7% |
| HKCG | 3 HK | REDUCE | HKD | 19.02 | 16.50 | -13.2% | 16,021 | 24.2 | 28.2 | 25.8 | 23.8 | 3.8 | 3.9 | 3.6 | 3.4 | 19.8 | 18.5 | 17.4 | 16.3 | 16.3% | 14.2% | 14.5% | 14.6% | 7.3% | 7.8% | 8.1% | 8.5% |
| Covered Average | | | | | | 8.1% | 5,498 | 46.1 | 22.1 | 19.6 | 16.8 | 5.1 | 3.0 | 2.5 | 2.2 | 18.4 | 12.8 | 10.1 | 8.6 | 12.2% | 15.4% | 13.6% | 14.0% | 5.1% | 6.8% | 6.7% | 6.9% |
| Sino Gas* | 260 HK | NR | HKD | 0.38 | na | na | 104 | na | na | na | na | 1.3 | na | na | na | 17.9 | na | na | na | -1.1% | na | na | na | -0.6% | na | na | na |
| China Oil Gas* | 603 HK | NR | HKD | 1.01 | na | na | 645 | 30.0 | 30.6 | 20.2 | 14.2 | 2.4 | 2.0 | 1.7 | 1.4 | 9.8 | 8.5 | 6.0 | 4.7 | 8.4% | 7.0% | 7.4% | 9.2% | 4.3% | 6.5% | 7.4% | 4.5% |
| Sino Oil Gas* | 702 HK | NR | HKD | 0.49 | na | na | 423 | na | na | 8.1 | 3.8 | 6.3 | 46.9 | 8.1 | 2.8 | na | na | na | na | -13.4% | 18.2% | 73.8% | 60.6% | -9.5% | 10.9% | 49.1% | 45.3% |
| Suntien Green* | 956 HK | NR | HKD | 2.58 | na | na | 453 | na | na | na | na | na | na | na | na | na | na | na | na | 14.2% | na | na | na | 3.4% | na | na | na |
| Tian Lun Gas* | 1600 HK | NR | HKD | na | na | na | na | na | na | na | na | na | na | na | na | na | na | na | na | 53.4% | na | na | na | 17.0% | na | na | na |
| Zhengzhou Gas* | 3928 HK | NR | HKD | na | na | na | 270 | 9.4 | 8.4 | 7.3 | na | 2.0 | 1.9 | 1.6 | na | 4.6 | 4.5 | 4.4 | na | 21.9% | 21.0% | 19.0% | na | 12.0% | na | na | na |
| Zhongyu Gas* | 8070 HK | NR | HKD | 0.71 | na | na | 181 | 74.0 | na | na | na | 2.2 | na | na | na | na | na | na | na | 3.0% | na | na | na | 1.3% | na | na | na |
| Enviro Energy* | 8182 HK | NR | HKD | 0.46 | na | na | 163 | na | na | na | na | 2.3 | na | na | na | na | na | na | na | -15.7% | na | na | na | -10.9% | na | na | na |
| Tianjin Tianlian* | 8290 HK | NR | HKD | 1.62 | na | na | 243 | 22.9 | na | na | na | 2.4 | na | na | na | 13.9 | na | na | na | 10.8% | na | na | na | 9.4% | na | na | na |
| China Energy* | CEGY SP | NR | SGD | 0.17 | na | na | 165 | na | na | na | na | 0.9 | na | na | na | na | na | na | na | -10.4% | na | na | na | -6.4% | na | na | na |
| Green Dragon* | GDG LN | NR | USD | 8.30 | na | na | 1,000 | na | na | na | na | 1.4 | 1.6 | 1.7 | 1.7 | 586.4 | na | na | 22.4 | -5.7% | -4.3% | -3.7% | -1.0% | -3.9% | -3.1% | -2.5% | -0.6% |
| Overall Average | | | | | | | | 41.7 | 21.5 | 17.3 | 15.1 | 3.5 | 5.6 | 2.8 | 2.2 | 63.4 | 11.4 | 9.0 | 32.1 | 8.4% | 13.6% | 17.5% | 16.7% | 2.9% | 6.2% | 10.1% | 9.8% |

| Company Name | Ticker | 09-12F EPS CAGR (%) | PEG | FCF yield | Dividend Yield | Dividend payout ratio | Net debt / equity | Net debt / capital | EBITDA / net interest | | | | | | | | | | | | | | | | | |
|---------------------|---------|---------------------|------|-----------|----------------|-----------------------|-------------------|--------------------|-----------------------|-------|-------|--------|--------|-------|-------|-------|-------|------|------|-----|-------|-------|------|------|-------|------|
| | | | 09 | 10F | 11F | 12F | 09 | 10F | 11F | 12F | | | | | | | | | | | | | | | | |
| CR Gas | 1193 HK | 30.7% | 0.8 | 2.1% | 5.3% | 2.0% | 2.6% | 2.0% | 20.0% | 20.0% | 20.0% | 48.9% | 24.4% | cash | 37.0 | 124.8 | na | na | na | | | | | | | |
| Beijing Enterprises | 392 HK | 21.4% | 0.9 | 1.1% | 1.1% | 1.3% | 2.1% | 20.0% | 30.8% | 30.8% | 30.8% | 4.9% | 8.4% | cash | 3.5% | 3.2% | 2.6% | 6.3 | 7.0 | | | | | | | |
| Kunlun Energy | 135 HK | 44.9% | 0.4 | 0.0% | 2.0% | 2.3% | 4.6% | 28.7% | 28.7% | 28.7% | 28.7% | 61.4% | 49.9% | cash | 29.0% | 9.3% | 6.6% | 7.0 | 4.8 | | | | | | | |
| ENN Energy | 2688 HK | 16.1% | 1.4 | 2.2% | 1.7% | 3.8% | 4.9% | 25.0% | 25.0% | 25.0% | 30.0% | 26.1% | 19.4% | cash | 20.7% | 16.2% | 18.2% | 5.2 | 5.3 | | | | | | | |
| Towngas China | 1083 HK | 20.1% | 1.1 | 0.4% | 0.8% | 1.1% | 1.6% | 20.0% | 20.0% | 20.0% | 20.0% | 26.1% | 19.4% | cash | 17.1% | 13.8% | 12.1% | 3.6 | 4.2 | | | | | | | |
| China Gas* | 384 HK | 95.3% | 0.2 | na | 0.0% | 4.9% | 6.1% | 1.0% | 0.3% | 0.4% | 0.5% | 256.4% | 229.1% | cash | 69.2% | 50.5% | 30.4% | 2.0 | 2.5 | | | | | | | |
| HKCG | 3 HK | 0.5% | 58.2 | 0.9% | 1.4% | 1.7% | 1.8% | 1.8% | 2.1% | 2.4% | 2.6% | 22.1% | 22.4% | cash | 22.9% | 23.6% | 18.1% | 8.4 | 6.9 | | | | | | | |
| Covered Average | | 32.7% | 1.1% | 1.8% | 1.4% | 2.4% | 3.4% | 1.0% | 1.2% | 1.4% | 1.7% | 70.0% | 65.8% | 28.3% | 20.1% | 27.9% | 18.3% | 10.5 | 22.4 | | | | | | | |
| Sino Gas* | 260 HK | na | na | -1.1% | na | na | na | na | na | na | na | 13.4% | na | na | na | na | na | 4.7 | na | na | | | | | | |
| China Oil Gas* | 603 HK | 33.8% | 0.9 | 4.6% | -17.8% | -10.3% | -12.5% | 0.0% | 0.0% | 0.0% | 0.0% | cash | cash | na | na | na | 22.1 | na | na | | | | | | | |
| Sino Oil Gas* | 702 HK | -355.1% | na | -2.2% | na | na | na | 0.0% | 0.2% | 0.2% | 0.2% | 5.0% | na | na | na | na | na | na | na | na | | | | | | |
| Suntien Green* | 956 HK | na | na | na | na | na | na | na | na | na | na | 441.3% | na | na | na | na | 2.0% | na | na | na | | | | | | |
| Tian Lun Gas* | 1600 HK | na | na | na | na | na | na | na | na | na | na | 137.9% | na | na | na | na | 0.7% | na | na | na | | | | | | |
| Zhengzhou Gas* | 3928 HK | na | na | na | na | na | na | na | na | 0.5% | 0.4% | cash | cash | na | na | na | cash | na | na | na | | | | | | |
| Zhongyu Gas* | 8070 HK | na | na | na | na | na | na | na | na | na | na | cash | na | na | na | na | 0.2% | na | na | na | | | | | | |
| Enviro Energy* | 8182 HK | na | na | -3.3% | na | na | na | na | na | na | na | cash | na | na | na | na | cash | na | na | na | | | | | | |
| Tianjin Tianlian* | 8290 HK | na | na | -3.0% | na | na | na | na | na | na | na | cash | na | na | na | na | cash | na | na | na | | | | | | |
| China Energy* | CEGY SP | na | na | -11.8% | na | na | na | na | na | na | na | cash | na | na | na | na | cash | na | na | na | | | | | | |
| Green Dragon* | GDG LN | -35.2% | na | -1.2% | na | na | na | na | na | na | na | cash | 4.4% | 6.7% | 3.1% | na | na | na | na | na | na | na | na | na | na | na |
| Overall Average | | -42.7% | 8.0 | -0.2% | -0.7% | 0.8% | 1.4% | 0.5% | 1.3% | 1.6% | 1.8% | 95.0% | 55.6% | 24.7% | 17.3% | 18.9% | 26.7% | 24.3 | 22.4 | 5.5 | 14.2% | 18.3% | 2.9% | 6.2% | 10.1% | 9.8% |

Note: Pricing as of 2 November 2010

China Gas' financial year ends in Mar

Not rated stock data are Bloomberg estimates

Source: Company data, Bloomberg, Nomura estimates

Exhibit 3. Comparison of operational metrics (I)

| | 2009A | 2010F | 2011F | 2012F |
|--|--------|--------|--------|--------|
| New Household connections (k) | | | | |
| China Resources Gas | 1,238 | 3,913 | 735 | 808 |
| Beijing Enterprises | na | na | na | na |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 788 | 702 | 881 | 855 |
| Towngas China | 193 | 237 | 149 | 160 |
| China Gas | 419 | 658 | 842 | 1,088 |
| Accumulated Households (k) | | | | |
| China Resources Gas | 3,437 | 7,349 | 8,084 | 8,893 |
| Beijing Enterprises | na | na | na | na |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 4,707 | 5,352 | 6,176 | 6,975 |
| Towngas China | 1,896 | 2,133 | 2,282 | 2,442 |
| China Gas | 3,745 | 4,837 | 6,047 | 7,135 |
| Number of city projects | | | | |
| China Resources Gas | 41 | 41 | 41 | 41 |
| Beijing Enterprises | 2 | 2 | 2 | 2 |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 79 | 89 | 89 | 89 |
| Towngas China | 49 | 57 | 57 | 57 |
| China Gas | 110 | 123 | 134 | 134 |
| Penetration rate (%) | | | | |
| China Resources Gas | 20% | 25% | 27% | 29% |
| Beijing Enterprises | 80% | 80% | 80% | 80% |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 32% | 36% | 41% | 46% |
| Towngas China | 34% | 34% | 35% | 37% |
| China Gas | 25% | 30% | 31% | 35% |
| City gas sales volume (mn m3) | | | | |
| China Resources Gas (All JVs) | 2,214 | 5,292 | 6,615 | 8,599 |
| Beijing Enterprises | 5,690 | 7,112 | 8,535 | 10,242 |
| Kunlun Energy | na | na | na | na |
| ENN Energy (unconsolidated) | 2,261 | 3,168 | 4,271 | 5,605 |
| Towngas China (All JVs) | 3,163 | 4,066 | 4,853 | 5,682 |
| China Gas (unconsolidated) | 2,130 | 3,380 | 4,348 | 5,175 |
| Long-distance pipeline sales volume (mn m3) | | | | |
| Beijing Enterprises | 14,390 | 15,829 | 18,203 | 20,934 |
| China Gas | 1,383 | 1,383 | 1,383 | 1,383 |
| Gas sales to C&I users as % of total volume | | | | |
| China Resources Gas | 70% | 70% | 70% | 70% |
| Beijing Enterprises | 86% | 86% | 86% | 86% |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 71% | 75% | 78% | 84% |
| Towngas China | 72% | 76% | 78% | 80% |
| China Gas | 86% | 87% | 86% | 86% |
| Gas sales volume growth | | | | |
| China Resources Gas | 62% | 139% | 25% | 30% |
| Beijing Enterprises | 16% | 25% | 20% | 20% |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 20% | 40% | 35% | 31% |
| Towngas China | 17% | 29% | 19% | 17% |
| China Gas | 249% | 59% | 29% | 19% |
| City gas average tariff (per m3) | | | | |
| China Resources Gas (HK\$) | 2.3 | 2.4 | 2.6 | 2.6 |
| Beijing Enterprises (RMB) | 2.0 | 2.1 | 2.4 | 2.4 |
| Kunlun Energy | na | na | na | na |
| ENN Energy (RMB) | 2.9 | 3.2 | 3.2 | 3.3 |
| Towngas China (RMB) | 2.0 | 2.3 | 2.6 | 2.6 |
| China Gas (HK\$) | 2.1 | 2.1 | 2.7 | 2.9 |
| Gas sales GPM | | | | |
| China Resources Gas | 25% | 22% | 21% | 21% |
| Beijing Enterprises | 15% | 16% | 15% | 16% |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 18% | 21% | 21% | 21% |
| Towngas China | 25% | 24% | 25% | 25% |
| China Gas | 34% | 28% | 28% | 29% |

Source: Company data, Nomura estimates

Exhibit 4. Comparison of operational metrics (II)

| | 2009A | 2010F | 2011F | 2012F |
|--|-------|-------|-------|-------|
| Connection fee per household | | | | |
| China Resources Gas | 2,792 | 2,792 | 2,792 | 2,792 |
| Beijing Enterprises | na | na | na | na |
| Kunlun Energy | na | na | na | na |
| ENN Energy (RMB) | 2,682 | 2,610 | 2,610 | 2,610 |
| Towngas China | 2,548 | 3,112 | 3,240 | 3,240 |
| China Gas | 2,766 | 2,781 | 2,823 | 2,950 |
| Connection fee GPM | | | | |
| China Resources Gas | 51% | 55% | 55% | 55% |
| Beijing Enterprises | na | na | na | na |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 63% | 62% | 62% | 62% |
| Towngas China | 60% | 60% | 58% | 58% |
| China Gas | 76% | 70% | 60% | 60% |
| Natural Gas sales as % of total revenue | | | | |
| China Resources Gas | 75% | 86% | 79% | 82% |
| Beijing Enterprises | 49% | 57% | 63% | 65% |
| Kunlun Energy | 40% | 40% | 43% | 71% |
| ENN Energy | 58% | 75% | 80% | 85% |
| Towngas China | 74% | 80% | 85% | 86% |
| China Gas | 42% | 38% | 39% | 40% |
| Connection fee as % of total revenue | | | | |
| China Resources Gas | 25% | 14% | 21% | 18% |
| Beijing Enterprises | na | na | na | na |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 30% | 23% | 19% | 15% |
| Towngas China | 24% | 19% | 14% | 13% |
| China Gas | 18% | 14% | 13% | 13% |
| Connection fee as % of total gross profit | | | | |
| China Resources Gas | 40% | 30% | 41% | 37% |
| Beijing Enterprises | na | na | na | na |
| Kunlun Energy | na | na | na | na |
| ENN Energy | 59% | 41% | 37% | 29% |
| Towngas China | 43% | 34% | 26% | 24% |
| China Gas | 60% | 48% | 39% | 39% |
| Revenue growth | | | | |
| China Resources Gas | 11% | 87% | 43% | 25% |
| Beijing Enterprises | 18% | 29% | 35% | 20% |
| Kunlun Energy | -22% | 40% | 21% | 117% |
| ENN Energy | 2% | 29% | 31% | 22% |
| Towngas China | -54% | 36% | 28% | 16% |
| China Gas | 148% | 61% | 44% | 27% |
| Overall GPM | | | | |
| China Resources Gas | 31% | 29% | 30% | 29% |
| Beijing Enterprises | 24% | 23% | 22% | 22% |
| Kunlun Energy | 35% | 42% | 41% | 37% |
| ENN Energy | 30% | 27% | 26% | 25% |
| Towngas China | 34% | 30% | 29% | 29% |
| China Gas | 23% | 21% | 19% | 20% |
| Overall EBITDA margin | | | | |
| China Resources Gas | 21% | 19% | 20% | 19% |
| Beijing Enterprises | 18% | 17% | 15% | 15% |
| Kunlun Energy | 36% | 42% | 39% | 28% |
| ENN Energy | 24% | 20% | 18% | 16% |
| Towngas China | 23% | 21% | 19% | 19% |
| China Gas | 17% | 17% | 14% | 14% |
| NPM | | | | |
| China Resources Gas | 12% | 11% | 11% | 10% |
| Beijing Enterprises | 10% | 11% | 11% | 11% |
| Kunlun Energy | 23% | 35% | 36% | 21% |
| ENN Energy | 10% | 9% | 8% | 7% |
| Towngas China | 13% | 13% | 13% | 14% |
| China Gas | 2% | 9% | 5% | 5% |

Source: Company data, Nomura estimates

Exhibit 5. Comparison of operational metrics (III)

| | 2009A | 2010F | 2011F | 2012F |
|---------------------------------|-------|-------|-------|-------|
| ROA | | | | |
| China Resources Gas | 7% | 6% | 7% | 6% |
| Beijing Enterprises | 4% | 5% | 5% | 6% |
| Kunlun Energy | 9% | 16% | 15% | 15% |
| ENN Energy | 5% | 6% | 6% | 5% |
| Towngas China | 2% | 3% | 3% | 4% |
| China Gas | 1% | 4% | 3% | 4% |
| ROE | | | | |
| China Resources Gas | 27% | 21% | 17% | 17% |
| Beijing Enterprises | 8% | 9% | 10% | 11% |
| Kunlun Energy | 10% | 17% | 18% | 20% |
| ENN Energy | 17% | 18% | 19% | 18% |
| Towngas China | 4% | 4% | 5% | 6% |
| China Gas | 3% | 24% | 12% | 12% |
| ROCE | | | | |
| China Resources Gas | 21% | 19% | 22% | 21% |
| Beijing Enterprises | 6% | 7% | 7% | 8% |
| Kunlun Energy | 12% | 20% | 18% | 17% |
| ENN Energy | 8% | 10% | 11% | 12% |
| Towngas China | 3% | 3% | 4% | 5% |
| China Gas | 1% | 6% | 5% | 7% |
| Net gearing | | | | |
| China Resources Gas | 49% | cash | cash | cash |
| Beijing Enterprises | 5% | 8% | 3% | 3% |
| Kunlun Energy | cash | cash | cash | cash |
| ENN Energy | 61% | 50% | 29% | 9% |
| Towngas China | 26% | 19% | 17% | 14% |
| China Gas | 256% | 229% | 69% | 51% |
| EBITDA interest coverage | | | | |
| China Resources Gas | 37.0 | 124.8 | na | na |
| Beijing Enterprises | 10.2 | 8.1 | 6.3 | 7.0 |
| Kunlun Energy | 7.0 | 4.8 | 5.0 | 3.2 |
| ENN Energy | 5.2 | 5.3 | 5.4 | 5.5 |
| Towngas China | 3.6 | 4.2 | 5.3 | 6.5 |
| China Gas | 2.0 | 2.5 | 3.3 | 4.5 |
| Current ratio | | | | |
| China Resources Gas | 0.9 | 1.6 | 1.6 | 1.6 |
| Beijing Enterprises | 1.5 | 1.5 | 1.6 | 1.7 |
| Kunlun Energy | 3.9 | 2.6 | 1.9 | 1.7 |
| ENN Energy | 0.9 | 1.0 | 1.1 | 1.2 |
| Towngas China | 0.7 | 0.8 | 0.9 | 1.0 |
| China Gas | 0.9 | 0.8 | 0.9 | 1.0 |
| Cash ratio | | | | |
| China Resources Gas | 0.6 | 1.2 | 1.2 | 1.2 |
| Beijing Enterprises | 0.9 | 0.9 | 0.9 | 1.0 |
| Kunlun Energy | 3.3 | 2.2 | 1.4 | 1.1 |
| ENN Energy | 0.5 | 0.6 | 0.7 | 0.8 |
| Towngas China | 0.4 | 0.5 | 0.6 | 0.6 |
| China Gas | 0.3 | 0.7 | 0.8 | 1.2 |
| Effective tax rate | | | | |
| China Resources Gas | 14% | 20% | 25% | 25% |
| Beijing Enterprises | 22% | 26% | 25% | 25% |
| Kunlun Energy | 21% | 23% | 23% | 23% |
| ENN Energy | 22% | 21% | 25% | 25% |
| Towngas China | 23% | 25% | 25% | 25% |
| China Gas | 35% | 13% | 18% | 22% |
| Effective interest rate | | | | |
| China Resources Gas | 2.6% | 2.0% | 2.5% | 2.5% |
| Beijing Enterprises | 3.7% | 4.0% | 4.7% | 4.7% |
| Kunlun Energy | 0.6% | 0.8% | 0.8% | 0.8% |
| ENN Energy | 7.0% | 6.0% | 6.5% | 6.5% |
| Towngas China | 5.0% | 5.0% | 4.7% | 4.2% |
| China Gas | 5.1% | 4.4% | 4.5% | 4.7% |
| CAPEX (RMB mn) | | | | |
| China Resources Gas | 599 | 1,058 | 1,323 | 1,720 |
| Beijing Enterprises | 2,257 | 2,689 | 2,557 | 2,634 |
| Kunlun Energy | 3,037 | 4,249 | 5,086 | 5,090 |
| ENN Energy | 1,541 | 2,000 | 1,500 | 1,200 |
| Towngas China | 528 | 300 | 300 | 250 |
| China Gas | 1,701 | 1,242 | 1,200 | 1,100 |

Source: Company data, Nomura estimates

Bullish on China gas distribution sector

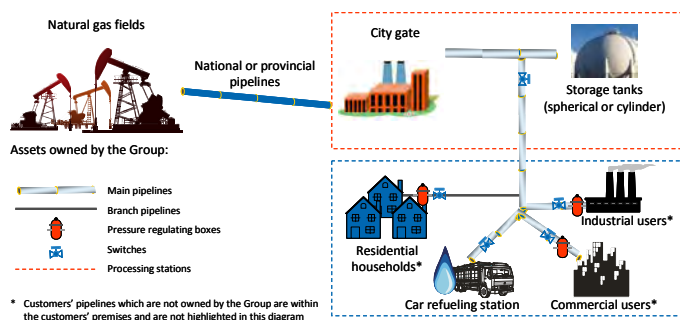
Natural gas – rising star in China's energy pie

Apart from renewable energy, natural gas is also one of the clean energy sources. As a result, natural gas plays an important role in the world's primary energy mix, which accounted for 23.8% as of 2009, according to BP Statistical Review. In the case of China, the situation is significantly different. Natural gas in China only represented a small proportion (i.e. 3.9%) of the total primary energy mix in 2009. We believe the two underlying reasons that affected the development of natural gas usage in China are: 1) abundant coal reserves in China offer a cheaper energy source than using natural gas; and 2) gas resources are generally located inland, which tends to lack infrastructures to connect gas supply to demand areas.

Until recently, with the awareness of reducing greenhouse gas emissions, natural gas becomes a new focus in China. Overall, we are Bullish on the China Gas Distribution sector, given:

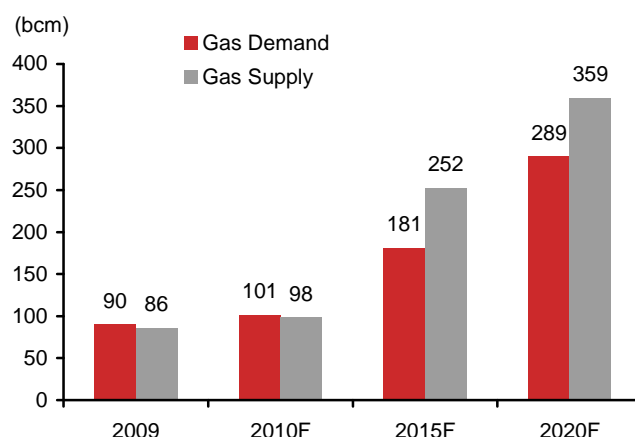
- More gas supply flowing to China – Positive
- Gas demand supports by the government's policy (12th Five-Year Plan) – Positive
- Foreseeable gas pricing reform – Neutral to Positive
- Moving to consolidation – Positive

Exhibit 6. China: Natural gas business model



Source: BP, Nomura research

Exhibit 7. Gas supply > demand in short run



Source: CEIC, Nomura estimates

Gas Supply

More gas supply flowing to China

Gas reserves in China

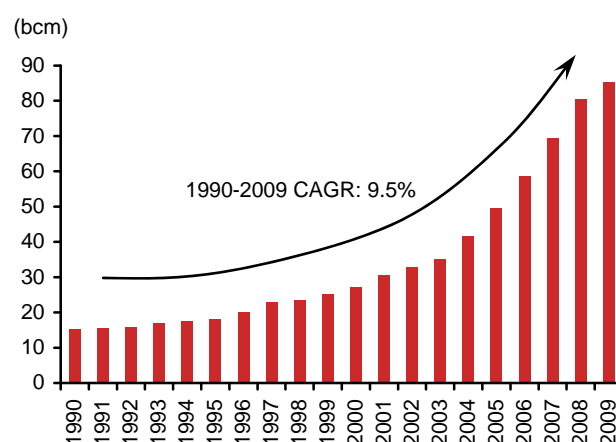
By the end of 2009, China had proven natural gas reserves of 2.46tcm, which accounted for 1.3% of the world's total reserve. As the map below shows, the majority of China's gas reserves are located inland (i.e. western and north-western parts) of China. Since demand areas are mostly located in the eastern part, there is a mismatch between gas demand and supply in China. In 2009, China's natural gas production was 85.2bcm, or a 1990-2009 CAGR of 9.5%. With strong gas demand having outpaced the gas supply over the previous few years, China turned from a gas-export country to a gas-import country from 2007. In 2009, we estimated around 3.5bcm of gas consumption needs were met by imports.

Exhibit 8. China natural gas reserves



Source: CNPC, IEA, Nomura research

Exhibit 9. China: Natural gas production



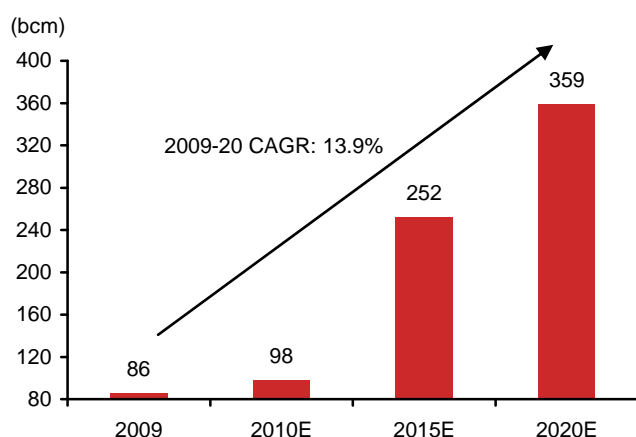
Source: CEIC, Nomura research

Future natural gas supply trend

In the next couple of years, more gas pipelines will be coming on-stream. Along with increased LNG supplies, we expect sufficient gas supply to meet China's strong gas demand growth. For 2010F, we estimate total gas supply of 98bcm, with the majority coming from domestic production. By 2015F and 2020F, we expect total gas supply to reach 252bcm and 359bcm, respectively, with a significant proportion coming from imports. We believe the new gas sources will relieve the gas supply bottleneck since 2010, resulting in supply outweighing demand by 2012F.

We project gas supply to reach 98bcm by 2010F, 252bcm by 2015F and 359bcm by 2020F, with supply outweighing demand by 2012F

Exhibit 10. China: Natural gas supply forecast



Source: CEIC, Nomura estimates

Exhibit 11. China: Breakdown of natural gas supply

| | 2009 | 2010F | 2015F | 2020F |
|---------------------|-----------|-----------|------------|------------|
| Domestic production | 81 | 87 | 122 | 171 |
| LNG | 5 | 5 | 58 | 76 |
| Pipeline | — | 6 | 72 | 112 |
| Total | 86 | 98 | 252 | 359 |

Note: Pipelines includes: W2E II (30bcm) & III (30-40bcm), Burma to China (12bcm), Russia to China (30bcm)

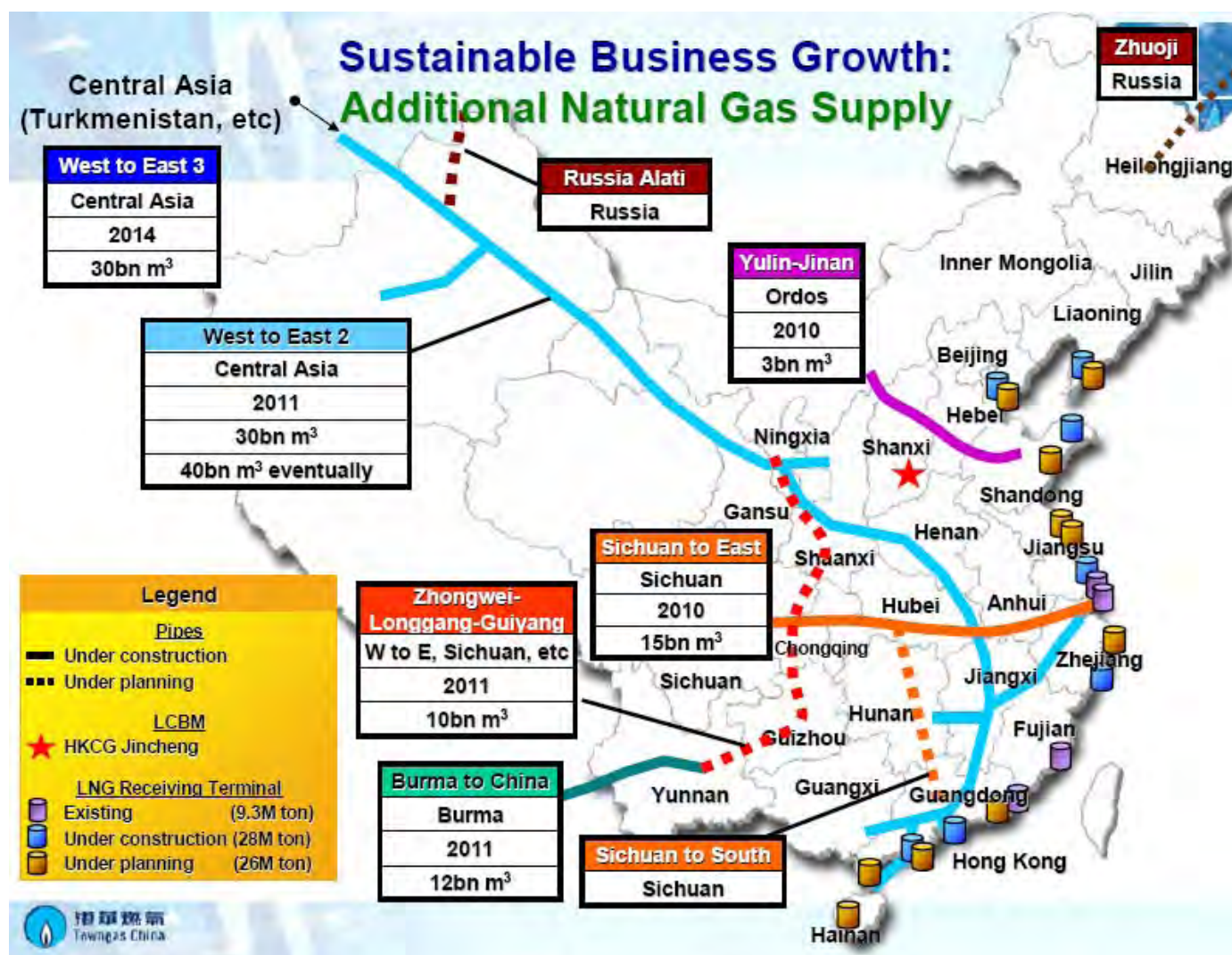
No CBM supply is included in this case

Source: Nomura estimates

Future sources of gas supply

The future gas supply will be coming from: 1) several trunks of new gas pipelines; 2) LNG terminals; 3) coal bed methane (CBM); and 4) shale gas.

Exhibit 12. China: Existing, developing and planning gas pipeline networks



Source: Company data

Supply – Gas pipelines

New gas pipelines coming online

Besides the first long-distance pipeline, which has commenced operations, there is a roadmap for more pipelines to come online, which will increase China's gas supply in the next few years. The Sichuan-to-East pipeline has started in end-August and the West-to-East Pipeline II will come on-stream in 2011. Alongside the West-to-East Pipelines III & IV, the Burma-to-China pipeline and potential supply from Russia will also greatly increase China's gas supply and relieve its gas shortage pressure.

Gas supply ramping up in the next few years, with more new gas pipelines starting operation

Exhibit 13. China: Gas pipeline details

| Pipeline | Date of commercial operation | Length (km) | Capacity (bn m3) | Gas sources | Operator | Investment (RMBbn) |
|------------------|------------------------------|-------------|------------------|--|----------|--------------------|
| West-to-East I | Dec-04 | 3,900 | 17 | Tarim Basin in Western China | CNPC | 120 |
| West-to-East II | 2011 | 4,843 | 30 | Central Asia (Turkmenistan, Uzbekistan & Kazakhstan) | CNPC | 142 |
| West-to-East III | 2014 | 4,661 | 30 | Central Asia | CNPC | n.a. |
| West-to-East IV | 2015 | NA | 17 | Central Asia and/or Tarim Basin | CNPC | n.a. |
| Sichuan-to-East | Sep-10 | 2,170 | 12 | Puguang | Sinopec | 63 |
| Burma to China | 2012 | 2,806 | 12 | Burma's west coast | CNPC | 70 |
| Yulin-Jinan | End 2010 | 928 | 3 | Eeruduosi | Sinopec | 8 |
| Daqing-to-Harbin | 2008 | 110 | 5 | Daqing Oil Field | CNPC | 1 |
| Russia-China | 2015 | NA | 30 | Russia | NA | NA |

Source: Nomura research

Gas supply from Russia

As the table above shows, there is planned gas supply from Russia to China. The China National Petroleum Corporation (CNPC) recently signed an agreement with Russian state-controlled gas monopoly, Gazprom, to export natural gas to China. Under the agreement, Russia will supply China with 30bcm of gas annually for 30 years starting from late-2015, with the final agreement to be signed by mid-2011. Negotiations between Russia and China on the natural gas supply deal have started since 2006, with the previous mentioned volume to be supplied of 70bcm. However, due to pricing disagreement, the previous supply target (i.e. starting from 2011) had already been delayed to the current estimate of late-2015. We believe Russia is demanding international prices whereas China is using its domestic prices as a reference. This price difference, in our view, is likely to be a major hurdle to the negotiations.

Exhibit 14. Regions to benefit from new gas pipelines

| | Sichuan-to-East | West-to-East II | Yulin-to-Jinan | Burma-to-China |
|------------------------------|---|---|--|--------------------------------|
| Covered provinces | Sichuan, Chongqing, Zhejiang, Hubei, Anhui, Jiangsu, Jiangxi, Shanghai | Henan, Guangdong, Guangxi, Hunan, Anhui, Zhejiang, Jiangsu, Gansu | Shaanxi, Shandong, Shanxi, Henan | Yunnan |
| Nomura comment | More expensive at wellhead than W2E I, currently facing challenges on demand side | W2E #. 3 and 4 are being planned, might reach even Fujian | Expected to ease the current severe shortage in Shandong | Might be up on running in 2013 |
| Beijing Enterprises (392 HK) | — | Shaan-Jing pipeline III | — | — |
| China Gas (384 HK) | Chongqing, Zhejiang, Jiangsu, Anhui, Hubei | Guangdong, Jiangsu, Zhejiang, Anhui, Hunan | Shandong, Shaanxi | — |
| CR Gas (1193 HK) | Chongqing, Hubei, Zhejiang, Jiangsu, Anhui, Jiangxi, Sichuan | Anhui, Zhejiang, Jiangsu, | Shandong, Shanxi, Henan | Yunnan |
| ENN Energy (2688 HK) | Jiangsu, Jiangxi, Anhui, Shanghai | Henan, Guangxi, Guangdong, Zhejiang, Jiangsu | Shandong, Henan | — |
| Towngas China (1083 HK) | Sichuan, Chongqing, Zhejiang, Anhui, Jiangsu, Jiangxi | Guangdong, Guangxi, Anhui, Zhejiang, Jiangsu | Shandong | — |

Source: Company data, Nomura research

Supply – liquefied natural gas business

LNG terminals – ambitious construction plan

Over the past two to three years, China has secured several long-term contracts globally to gain access to natural gas through LNG to secure its future supplies of the commodity. The three oil giants in China, CNOOC, CNPC and Sinopec are active players in the LNG market, with CNOOC being the most aggressive one.

Exhibit 15. China: LNG terminals

| Operator | Terminal | Location | Capacity (mtpa) | | | | | | | Gas Sources | Notes |
|----------|--------------|-----------|-----------------|-----|-----|-----|-----|-----|-----|---|---|
| | | | 06-08 | 09 | 10F | 11F | 12F | 13F | 14F | | |
| CNOOC | Shenzhen | Guangdong | 3.7 | 5.7 | | | | 8.7 | | 1) North West Shelf (Australia) 3.3mtpa 2) Qatargas: 2mtpa in 2008, 2013 3mtpa more Australia | Capacity planned to expand to 10mtpa, but no timeline Qatargas considers to add 2mtpa more, totalling 5mtpa CNOOC's 2004 plan was 2.5mn tons while Australia's Icon Co. was signed to supply for 20 years with a Shenzhen company |
| | Shantou | Guangdong | | | | | | | 2 | | Original plan: 6mtpa by 2012F, but no timeline Previous plan: 3mtpa by 2012 and to 6mtpa in phase 2 Plan dated back to 2005 Apr, pending approval Phase 1 total capacity 3mn tons, currently under construction, phase 2 complete in 2017 with 7mn tons capacity Plan to expand to 6mtpa 3mtpa plan at preliminary stage |
| | Putian | Fujian | | 2.6 | | 5.2 | | | | Tangguh at Indonesia: 7.6mtpa | Previous plan: 2mtpa by 2012 and to 3mtpa by 2015F Phase 1 total capacity 2mn tons; phase 2 with 3mn tons capacity 3mn tons Phase 1, exact date of commercial operation unconfirmed |
| | Ningbo | Zhejiang | | | | | 3 | | | Might come from Queensland Curtis Australia, 3.6mtpa | |
| | Wenzhou | Zhejiang | | | | | | | | | |
| | Binhai | Jiangsu | | | | | 3 | | | | |
| | Yangshan | Shanghai | | 3 | | | | | | Malaysia: 3mtpa From offshore gas fields owned by CNOOC | |
| | Zhuhai | Guangdong | | | | 0.1 | | | 3 | Ya13-1 gas field, Dongfang 1-1 gas field and Ledong gas field | |
| | Yangpu | Hainan | | | | | 2 | | | | |
| | Qinhuang-dao | Hebei | | | 2 | | | | | | |
| CNPC | Yingkou | Liaonin | | | | | | | | | |
| | Dalian | Liaoning | | | | 3 | 3 | | | Qatar and Australia Signed agreement with Total S.A. from France for 25-30 years, 4mtpa | Expand to 6mtpa |
| | Tangshan | Hebei | | | | | 3.5 | | | From Australia, Qatar, W-E II and Hebei-Jiangsu gas pipeline; phase 2: 6mtpa | Expand to 6.5mn in phase 2 and 10mn in phase 3 |
| | Rudong | Jiangsu | | | | 3.5 | | | | Mainly from W-E pipeline II, but also target overseas LNG | Expand to 6mtpa in Phase 2 |
| Sinopec | Shenzhen | Guangdong | | | | | | 3 | | | Mainly from W-E II pipeline; 2.25mtpa from Exxon in Australia at around US\$17/mmbtu |
| | Tianjin | Tianjin | | | | | | | | | Original plan: 3mtpa by 2010F, preliminary green light from NDRC |
| | Qingdao | Shandong | | | | | 3 | | | Exxon Mobil supplying 2mtpa from PNG LNG | Original plan: 3mtpa by 2007 and 5mtpa in future |
| | Beihai | Guangxi | | | | | | | | | Original plan: 3mtpa in Phase 1, 5mtpa in Phase 2; currently preliminary stage Preliminary green light from NDRC |
| | Zhuhai | Guangdong | | | | | | | | | |

Source: Nomura research

Supply – coal-bed methane business

CBM – next source of gas supply

What is CBM?

Coal bed methane (CBM), also known as coal seam gas or coal seam methane, is a form of natural gas, and is notorious as the main cause of coal mine explosions. Unlike most gases that are stored in typical sandstone or other conventional gas reservoirs, methane is stored within the coal by a process called absorption. Methane, in a near-liquid state, lines the inside of pores within the coal (called the matrix). It can be used as natural gas in homes and in industry. CBM has some green attributes. Its use will help reduce emissions of greenhouse gases and increase energy supplies. And as a collateral benefit, tapping it will make coalmines safer.

Exhibit 16. Comparison of natural gas and CBM

| Comparison | Natural Gas | Coalbed Methane |
|---------------------|------------------------------|---|
| Application | Primary energy and chemicals | Primary energy and chemicals |
| Heat rate (kcal/m3) | 8,000-9,000 | 8,000-9,000 |
| Gas component | >90% | >95% |
| Reserve depth (km) | Average >1,500 | Average <1,500 |
| Pricing | Subject to NDRC decision | Market-driven, but will not be higher than NG in our view |

Source: Company data, Nomura research

Prospects

We believe CBM will gradually play a role in China's gas industry as an alternative to natural gas. According to the Ministry of Land and Resources, China's CBM resource ranks number three in the world, with total 36.8tcm (less than 2,000 metres deep) and 10.9tcm (less than 1,500 metres deep). About 30% of this is exploitable reserves. In China, regions with the most abundant CBM reserves include central north and northeast. However, we remain cautious on its uses in the near term, due to: 1) capital and technology bottlenecks; and 2) the need for infrastructure to transport the gas out of CBM wells.

A long-term substitute for natural gas, but near term remains cautious

Exhibit 17. Comparison of natural gas and CBM

| Start | Through | End |
|---------------------|---------------|----------------------------|
| Shizhuang, Shanxi | | Duanshi, Shanxi |
| Duanshi, Shanxi | Jincheng | Bo-ai, Shanxi |
| Zhengzhuang, Shanxi | | Yancheng, Shanxi |
| Linxian, Shanxi | Baode, Shanxi | Shaan-Jing pipeline I |
| Qinshui, Shanxi | | W2E Qinshui pressure point |
| Hecheng, Shaanxi | | Xi'an, Shaanxi |

Source: Company data, Nomura research

Exhibit 18. China: CBM resource locations

| Name | Province | Region | Resources (bcm) |
|-----------------------------------|--|-----------|-----------------|
| Sanjiang-Mulenghe Basin | Helongjiang | Northeast | 401 |
| Bohaiwan Basin | Shandong, Henan and Hebei | East | 1,375 |
| Nanhuabei Basin | Jiangsu, Anhui and Henan | East | 1,678 |
| Jinzhongnan Coalfield | Shanxi | Central | 4,837 |
| Pinle Basin | Jiangxi and Hunan | East | 44 |
| Xiangzhongnan Coal-bearing Area | Hunan | South | 18 |
| E'erdousi Basin | Inner Mongolia, Ningxia, Shanxi and Shanxi | West | 11,324 |
| Sichuan Basin | Sichuan | Southwest | 145 |
| Sichuan-Guizhou Coal-Bearing Area | Sichuan and Guizhou | Southwest | 1,121 |
| Liupanshui Coal-Bearing Area | Guizhou | Southwest | 1,334 |
| Zhunger Basin | Xinjiang | Northeast | 2,997 |
| Tuha Basin | Xinjiang | Northeast | 4,647 |
| Yini Basin | Xinjiang | Northeast | 925 |
| Total | | | 30,846 |

Source: Nomura research

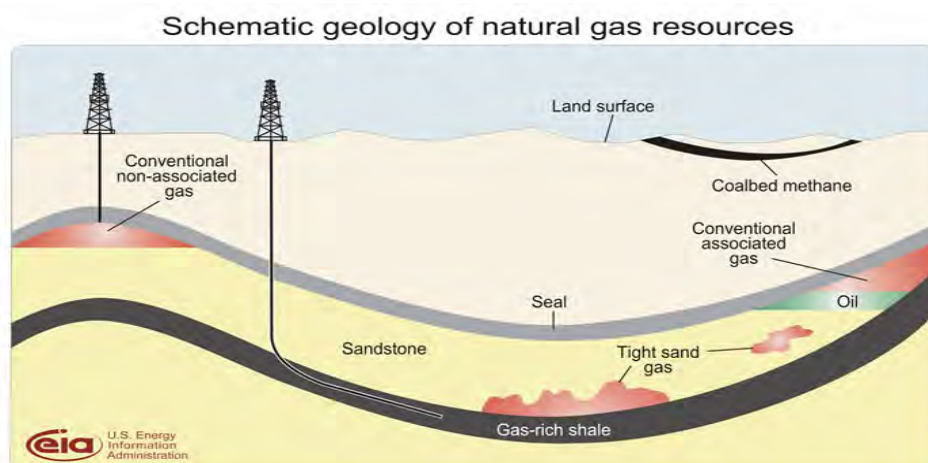
Supply – shale gas

Shale gas – early stage of development; not main source in near future

What is shale gas?

Shale gas is defined as a natural gas from shale formation, with the shale acting as both the source and the reservoir for the natural gas. Generally, shale gas deposits are often lower in resource concentration, more dispersed over large areas and require well stimulation or some other extraction or conversion technology, such as hydraulic fracturing, to produce.

Exhibit 19. Schematic geology of shale gas



Source: Energy Information Administration (EIA)

Prospects

From late-2009 to 1H10, China's Ministry of Land and Reserve determined eight national testing fields including Pengshui County in Chongqing, southern Sichuan, northern Guizhou, south-eastern Chongqing and north-eastern Chongqing. The CNPC in late-2009 started working on a shale gas exploration project with Royal Dutch Shell, whereas Sinopec worked with BP in Guizhou and northern Suzhou. In general, shale gas reserves have not been officially determined and all projects remain at the exploration stage due to lack of suitable technology for local geological characteristics and sizeable exploration costs. Based on academic studies in China, the total amount of shale gas reserve in China is around 26tcm, close to the US's 28.3tcm reserve.

On 27 October 2010, the deputy director of oil and gas strategy research at the Ministry of Land and Resources, Mr Zhang Dawei stated that China would offer shale gas blocks through auction to the country's biggest energy companies (PetroChina, Sinopec, CNOOC, and Shaanxi Yanchang Petroleum Group). The government will offer six shale-gas exploration blocks, each as large as 7,000km², in the provinces of Guizhou, Shanxi, Anhui, Zhejiang, and the municipality of Chongqing. The government will provide an exploration subsidy of RMB0.23-0.3/m³.

We consider it is still too early to discuss shale gas, given the technology in shale gas is in the early stage and there is an abundant reserve of CBM with more advanced technology than shale gas. We think any significant development for shale gas will likely not happen in the near term.

Too early to discuss shale gas; should become more popular following CBM, in our view

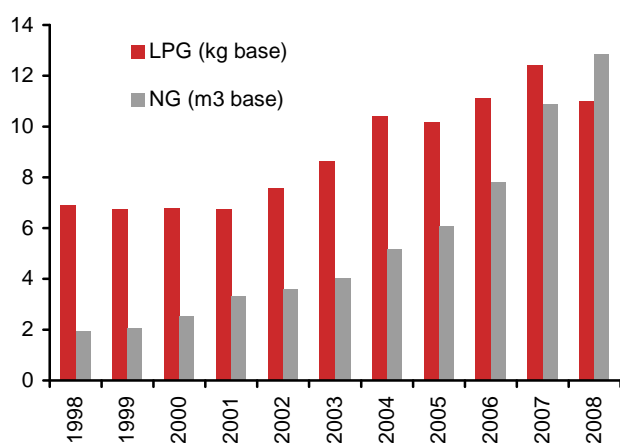
Supply – liquefied petroleum gas

LPG – limited room for growth

Although there are many regions still unreachable by pipelines, we think there is limited room for the liquefied petroleum gas (LPG) business to grow further in the longer run, because: 1) more piped natural gas supply (57.8% cheaper than LPG) will be available in the next few years when the gas infrastructures come online; 2) more convenient for households to use natural gas than bottled LPG; and 3) the government continues to push for natural gas usage to raise the share of natural gas in the primary energy from 3.9% in 2009 to 8.3% by 2015.

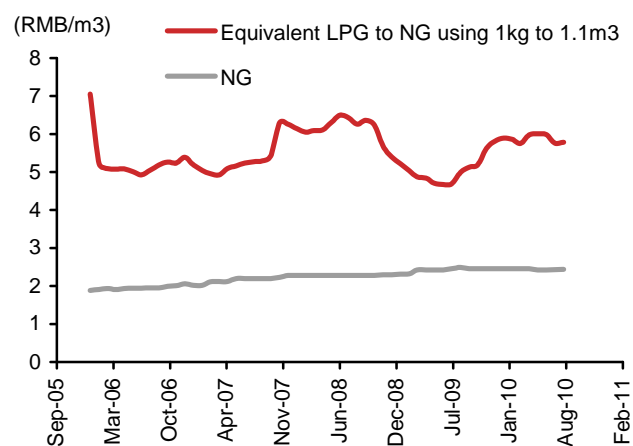
There is a place for the LPG business, but it is a rough and tumble sector

Exhibit 20. China: per capita energy consumption – natural gas vs LPG



Source: Nomura estimates

Exhibit 21. China: LPG vs NG price



Source: Nomura research

Nonetheless, we think it is unlikely for LPG to fully replaced by natural gas either in the residential or commercial space as: 1) some rural regions in China are not economically feasible to be connected with gas pipelines; 2) LPG as a by-product of oil refinery still has its market; and 3) LPG is still cleaner or emitting less CO₂ than oil and coal. As such, we believe there is still room for LPG to grow, albeit limited.

Supply – beneficiaries from more gas supply?

Who will benefit more from improved gas supply?

We think all downstream gas companies can benefit from the gas supply ramp-up, but companies with a presence in Anhui, Hunan, Hubei, Chongqing, Jiangxi and Jiangsu are likely to benefit the most from the new pipelines, in our view. Accordingly, we believe that ENN Energy and CR Gas will benefit the most, followed by China Gas. As most of Towngas China's projects are in Sichuan, where there is already an abundance of gas, we believe it will benefit less than its peers. Similarly, Beijing Enterprises' location means it has not suffered from gas shortages, and thus we believe that the benefits of improved gas supply are likely to be minimal.

Regionally, we believe that China Gas can benefit from the Daqing-to-Harbin and Jinan-to-Yulin pipelines, as most of its projects are in northern China. CR Gas, in our view, should benefit from the Burma-to-China pipeline as it has obtained concession rights in the Kunming new development zone, which will source gas from the Burma pipeline.

Major beneficiaries from improving gas supply – ENN Energy, CR Gas and China Gas

Gas demand

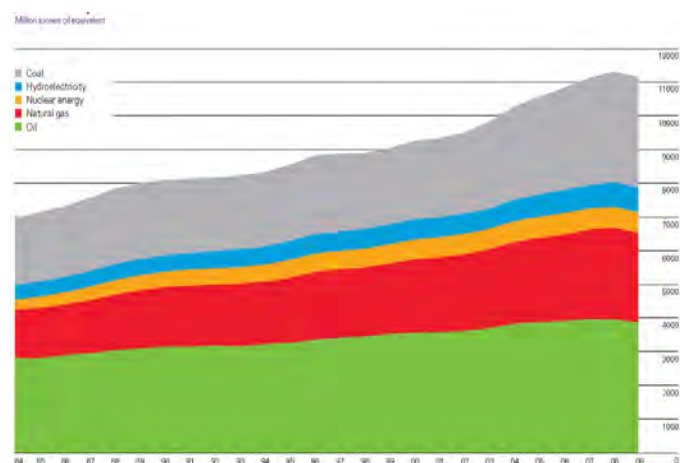
Strong gas demand growth ahead

Primary energy consumption: world vs China

As of 2009, oil still represented the largest proportion in the world's primary energy consumption, at 34.8%. With the surge in oil prices, coal and natural gas saw their importance in the energy consumption pie chart increased, at 29.4% for coal and 23.8% for natural gas. The case is different in China, as natural gas only accounted for a small proportion (3.9%) in China's primary energy consumption, significantly below the world's average of 23.8%.

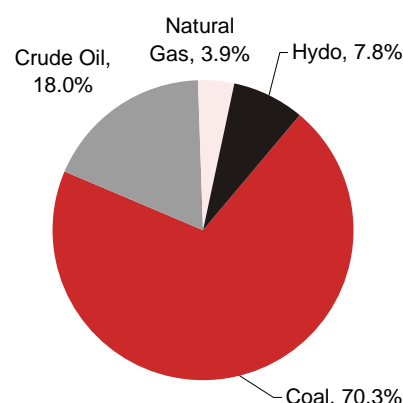
Gas plays an important role in global primary energy, but still in an early stage in China

Exhibit 22. World primary energy consumption



Source: BP Statistical Review, Nomura research

Exhibit 23. 2009 China primary energy mix



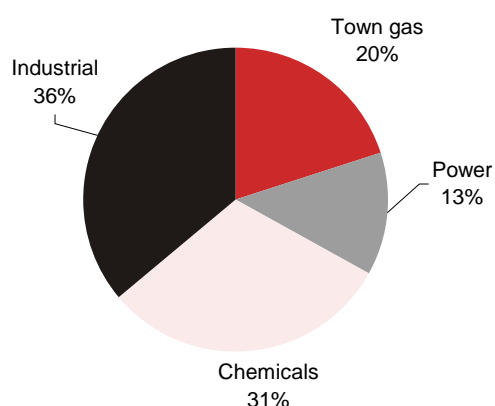
Source: BP, Nomura research

China gas demand growth: a 9.7% CAGR over 1990-2009

As mentioned earlier, natural gas only accounted for a small proportion in China's primary energy consumption. We believe this was mainly due to: 1) limited infrastructure (e.g. pipelines) to link gas supplies to demand areas; and 2) China's large coal reserve, which is cheaper than using gas. Despite the limitation, gas consumption still grew at a fast pace, at a 9.7% CAGR over 1990-2009. To better allocate natural gas resources amid the fast growing pace, the government implemented a natural gas utilization policy in 2007 to prioritize usage of natural gas in the country, with the priority given to residential, commercial and vehicular users. As of 2009, residential users only accounted for 20% of total gas consumption, with the majority belonged to industrial and chemical users, around 67% of the total.

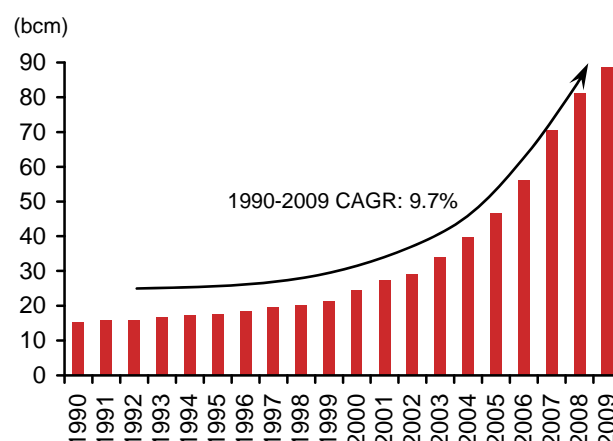
1990-2009 gas demand at a CAGR of 9.7%

Exhibit 24. China natural gas usage, 2009



Source: CEIC, Nomura estimates

Exhibit 25. China: natural gas consumption



Source: CEIC, Nomura research

Exhibit 26. Natural gas utilization policy

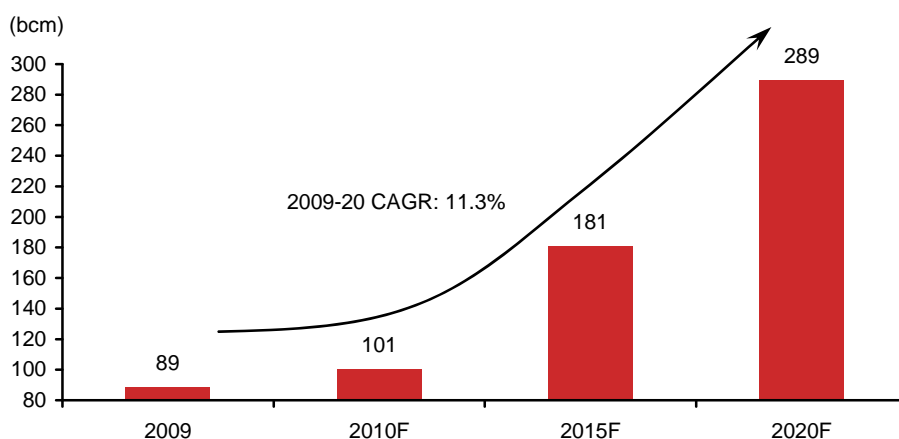
| Priority | Urban fuel | Residential usage (cooking) Public service and commercial usage (airport, government, schools, hotels, shopping mall, restaurants and offices) CNG vehicles Combined heat/cold with power system |
|------------|-------------------|--|
| Permitted | Urban fuel | Central heating / air-conditioning, household heating |
| | Industry fuel | Application of natural gas to replace LPG/oil in construction, mechanical, textile, petrochemical and metallurgical industries Application of natural gas in construction, mechanical, textile, petrochemical and metallurgical industries which provides higher environmental and economical efficiency than using coal Application of natural gas in construction, mechanical, textile, petrochemical and metallurgical industries on an interruptible basis |
| | Power generation | Peak load gas-fired power plants in areas with sufficient gas supply |
| | Chemical industry | Natural gas to hydrogen projects with high economic benefits but low gas demand Natural gas to nitrogenous fertilizer projects |
| | | |
| Restricted | Power generation | Non-peak load gas-fired power plants |
| | Chemical industry | Expansion of ammonia projects using gas |
| Forbidden | Power generation | Base-load power generation in the areas with large coal reserve |
| | Chemical industry | Methanol projects |

Source: NDRC, Nomura research

Strong gas demand growth ahead

In the next couple of years, more gas pipelines will be coming on-stream, including West-to-East Pipeline II, Sichuan-to-East, etc., which can provide sufficient gas resources to fulfil China's rising gas demand. Our base-case assumes that China would enjoy a gas demand CAGR of 11.3% over 2009-20F, with gas consumption of 181bcm by 2015F and 289bcm by 2020F. We are confident that China will achieve our base-case estimates, due to: 1) natural gas' pricing competitiveness and 2) government's support.

We project a 2009-20F demand CAGR of 11.3%, with gas consumption at 181bcm (2015F) and 289bcm (2020F)

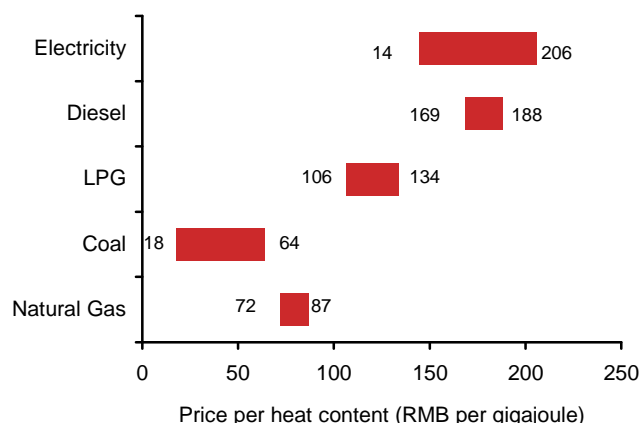
Exhibit 27. China: Natural Gas Demand Forecast

Source: CEIC, Nomura estimates

- **Price competitiveness of natural gas in China** – In China, the wellhead gas price is determined by the central government and the retail price is determined by the local pricing bureau. Compared to other major competing products, such as LPG and diesel, which are more closely correlated to crude oil prices, the natural gas tariff enjoys a 33.8-55.4% cost advantage. Despite the recent increase in the wellhead gas price and in turn the retail gas tariff, natural gas still maintains its pricing competitiveness in China over major energy sources.

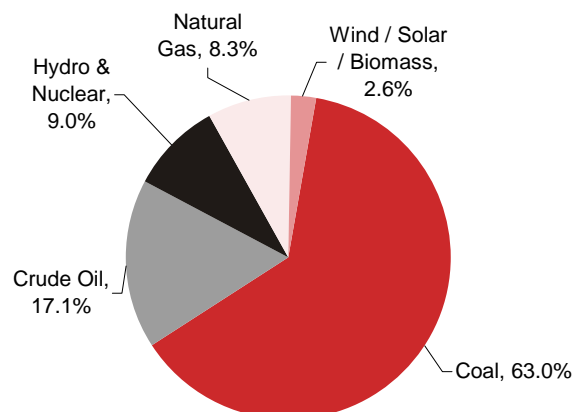
Gas price is 33.8-55.4% cheaper than LPG and diesel

Exhibit 28. China: Price comparison (Sep 2010)



Source: CEIC, CCTD, Nomura research

Exhibit 29. China: 2015 primary energy mix (NDRC)



Source: NDRC, Nomura research

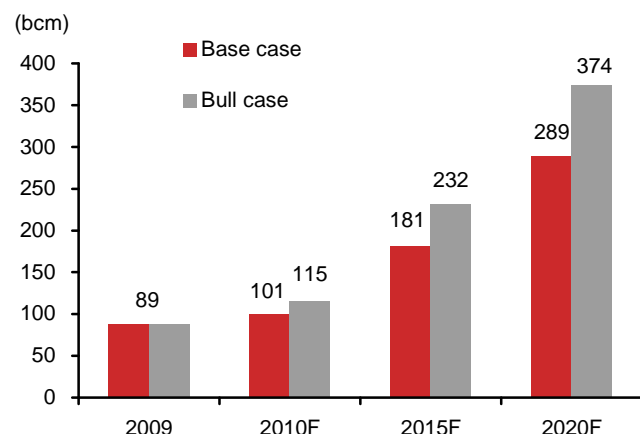
- Government's supportive stance** – The government targets to raise the natural gas proportion in the primary energy mix from 3.9% in 2009 to 8.3% (implying 260bcm) in 2015, as depicted under the 12th Five-Year Plan. Although we are not as optimistic as the government, we are positive over the government's support. We are confident that our gas demand forecasts of 181bcm and 289bcm by 2015F and 2020F, respectively, are achievable.

The 12th FYP promotes gas usage in primary energy mix, from 3.9% in 2009 to 8.3% in 2015F

More potential upside to our forecasts?

Depending on the government's policy on natural gas usage, e.g. gas usage on gas-fired power plants, chemical projects etc., gas demand in China may have the potential to reach our bull-case number, implying a gas demand CAGR of 14% over 2009-20F.

Exhibit 30. China: natural gas forecast (bull & base cases)



Source: CEIC, Nomura estimates

Exhibit 31. China: 2015F natural gas forecasts

| (bn m3) | 2015F |
|---------|-------|
| CNPC | 220 |
| IEA | 140 |
| NDRC | 260 |
| Sinopec | 250 |

Source: Company data, Nomura research

Adverse effects of cold winter – positive or negative?

This year, China is expected to face an extremely cold winter and gas demand is expected to surge for household heating purposes, according to government expectations. However, we consider this may not be positive for gas distributors, as we believe their gas sales margins may narrow since higher-cost gas (such as gas from Sichuan to East, LNG, etc.) is required to allocate to the low-margin residential segment. Across the gas distribution space, we believe Towngas China and China Gas will feel the most adverse impact, given the higher proportion of residential users with delays in wellhead price hikes. On the other hand, we believe BJE will be less affected by the extreme weather conditions. Instead, we expect it to benefit from the strong gas demand from the cold weather since BJE is not facing any gas shortages.

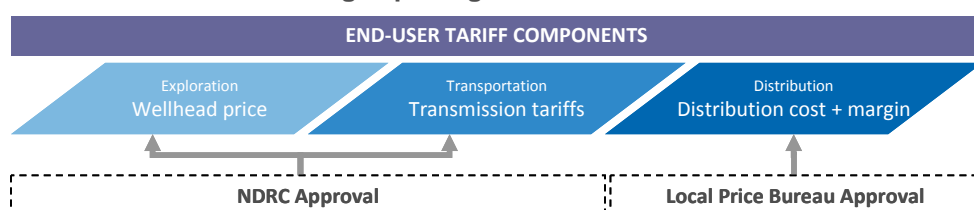
Sales margin may narrow due to cold winter; Towngas China and China Gas are expected to be hit the hardest

Gas pricing

Pricing – cost pass through to be maintained

For the natural gas sales business, natural gas raw material costs, a major cost, basically consists of two parts: wellhead prices and transportation costs. The transportation cost is about RMB0.05/m³/100km in China, while the wellhead price is determined principally by natural gas production costs and producers' appropriate margins. The cost review / adjustment generally takes place once a year. Normally, a three-to-six month period is needed for a distributor to pass on the cost hike to residential users, as approval from the local pricing bureau is required through a public hearing. For commercial and industrial users, the time lag to pass the cost hike is generally shorter than that for residential users, and sometimes the pass-through will be applied retrospectively, which provides a protection for the distributor's dollar margin.

Exhibit 32. China: Natural gas pricing structure



Source: Company data, Nomura research

June wellhead price hike – mostly passed through to end users

The NDRC announced a wellhead gas price hike of RMB0.23/m³ effective from 1 June 2010, a 24.9% increase on average. Further to the wellhead price hike, per industry players, the non-residential sector raised the gas tariff by the same magnitude or more, i.e. effective from 1 June. For the residential sector, given that a gas tariff hike is required to go through a public hearing by the local pricing bureau, a three-to-six month time lag is expected. The local governments have already started the public hearing for the gas price hike in the residential sector since August. We believe downstream players should be able to pass on the hike to both residential and non-residential customers, despite the time lag. With the magnitude of the gas price hike to be the same or more than the gas cost increase, we expect distributors to maintain their absolute dollar margins, but may see a dip on a percentage basis.

The June wellhead price hike should be able to pass through, though a time lag is expected

Exhibit 33. Status of wellhead price pass through

| Source | Comment | Status |
|---------------------|---------------------------|--|
| CR Gas | Neutral-to-positive | Retrospective tariff hike (i.e. 1 June) for C&I; the magnitude should be able to cover any pass through delay in residential sector |
| Beijing Enterprises | Neutral | Tariff up RMB0.33/m ³ for C&I; pending public hearing for residential sector. The company will liaise with PetroChina if the wellhead price hike can be applied at the date when the downstream price increased. |
| ENN Energy | Neutral-to-positive | Only 26 out of 88 projects have wellhead price hike, at an average of RMB0.29/m ³ . 15 projects have received the pass through, at RMB0.4/m ³ . The remaining is pending from public hearing. The magnitude of RMB0.4/m ³ should be able to cover any pass through delay. |
| Towngas China | Short-term margin squeeze | - C&I: Tariff up RMB0.3-0.35/m ³ retrospectively, i.e. from 1 June - Residential: 40% of the projects have been passed through; the remaining is pending from public hearing |
| China Gas | Short-term margin squeeze | - C&I: Tariff up RMB0.35-0.4/m ³ retrospectively, i.e. from 1 June - 34 out of 99 projects have received the pass through; the remaining is pending from public hearing |

Source: Company data, Nomura research

Expected upward trend for gas prices

We believe the recent wellhead price hike was due to two major reasons: 1) strong gas demand amid limited gas supply; and 2) gas costs from the Sichuan-to-East pipeline (around RMB1.51/m³) are higher than those from other existing pipelines (e.g. around RMB0.7/m³ for W2E Pipeline I), which increase the average gas cost. Although more gas supplies will be available starting from 2H10, gas prices will likely still be on an upward trend to close the gap between domestic and international prices, in our view, given:

- Domestic and International Prices – With the same heat content, international gas prices are about 60% of crude oil prices, whereas gas prices in China are only about 25% of crude oil prices;
- W2E Pipeline II – The new gas supply will be mainly from W2E pipeline II, which will start in 2011. The gas supply for W2E Pipeline II is from Central Asia, including Kazakhstan and Turkmenistan, which have pricing based on international prices (roughly at RMB2/m³); and
- Relative to Renewable Energy – Gas is one of the clean energy sources. However, gas prices are much cheaper than other renewable energy sources, such as wind and solar energy.

New development in Hebei province

The Hebei provincial government issued a “Trial Measures of Hebei Province for the Administration of Price of Natural Gas (for Trial Implementation), with effect from 20 August 2010. The terms included in the announcement are consistent with the current practice in the gas distribution industry, with connection fees, residential and CNG tariffs to be determined by the government, and the C&I tariff to be guided by the government. However, we note two new developments have been included in the announcement:

- Implementation of an automatic pass-through mechanism; and
- Implementation of linking CNG and diesel prices, and the excess return derived from the CNG business, i.e. CNG price – cost – reasonable return, is required to give to the provincial government. We believe the definition of reasonable return in this case is an ROE of 8%. Further details of the implementation will be announced later.

We believe the implementation of an automatic pass-through mechanism is a long-term direction of the government and is positive to the industry, given any wellhead price hike will be automatically passed through to residential customers, and gas distributors will not suffer from any margin squeeze. As for the implementation of a linkage between CNG and diesel prices, we believe this is potentially negative, as it could lower the returns of the gas distributors. Unlike the first development, we believe the second development is difficult to be implemented nationwide, since:

- The development level of different city varies, and is difficult to apply the fixed ROE to every project;
- The ROE is subject to the leverage ratio of each project; and
- This policy tends to discourage gas investment, which is against the government’s plan of promoting the gas usage.

For Hebei alone, the impact on gas distributors should be immaterial, as only China Gas and ENN Energy have more presence in Hebei.

Exhibit 34. Presence in Hebei province

| Company | Projects | No. of CNG stations |
|---------------------|---|---------------------|
| Beijing Enterprises | - | - |
| China Gas | Cangzhou, Nanpixian, Qinghexian, Wangdu city, Tangshan Nampo, Letingxian, Xinle, Gaocheng, Pingshanxian, Fengnan District of Tangshan, Neiqiuxian, Bohai New Zone | - |
| China Resources Gas | Hengshui | - |
| ENN Energy | Langfang, Shijiazhuang, Luquan, Luanxian | 21 |
| Towngas China | - | - |

Source: Company data, Nomura research

Potential gas pricing reform?

Given the expected higher gas costs from new gas supplies in the near future, the industry is talking about a possible gas pricing reform in the near future. Upstream suppliers are proposing “one province, one price” or unification of residential and non-residential prices. We do not expect any significant gas pricing reform to be implemented in the near future. However, given the government’s support towards the efficient usage of natural gas, we continue to believe that the gas tariff hike will follow the wellhead price increase such that downstream players are able to pass on the increased costs to customers. The government and the industry players will also work on the automatic cost pass-through mechanism to reduce the period of margin squeeze. On a long-term basis, the government’s target is to open the gas market such that the market determines gas prices, with only the transportation tariff to be regulated by the government. Overall, we see a neutral impact on the industry as we believe the gas distributors are able to pass on the higher costs to end users, either at the same magnitude or more than the gas cost increase, such that at least the absolute dollar margin can be maintained.

We expected neutral impact to the gas distributors for any pricing reform

Connection fee

Connection fee? Construction fee? Capacity fee?

Since 26 December 2006, the connection fee for gas connection pipelines in Guangdong has been abolished. The fee structure, under a different name, has since been changed to comprise two parts: 1) construction fee and 2) capacity fee. The construction fee is collected when the connection is made, and is paid by the property developer and borne by residential users, whereas the capacity fee is collected once the connection is made and amortized over the lifetime of the gas service to residential users. Although the name has been changed, the fee structure remains the same and there is no significant impact on the gas distributors in Guangdong.

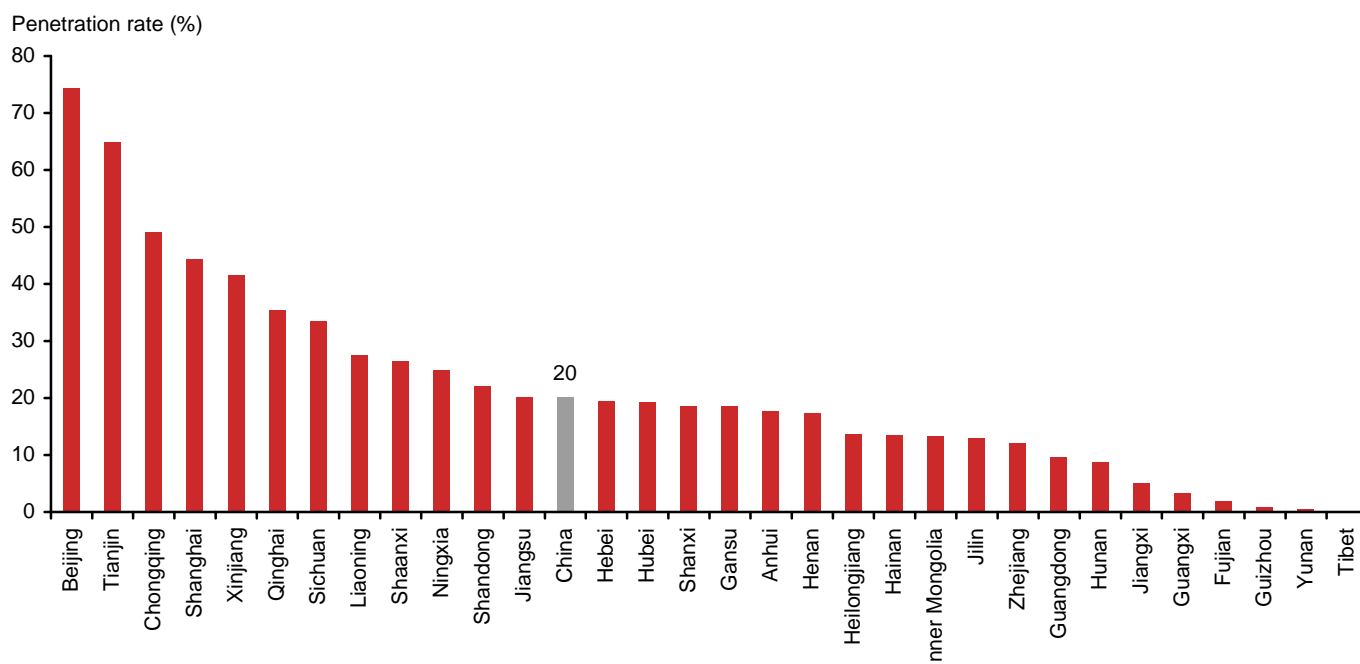
No change to the connection fee nature, despite names vary

Connection fee: still in place in the next few years, to be abolished in the long run

In our view, the connection fee should be maintained in the near future amid the current low penetration rate situation (average of 20%, with around 20-30% in most cities in China, compared to 80% in the matured cities in China). As mentioned earlier, the Chinese government plans to raise the gas usage rate from the current 3.9% to 8.3% of total primary energy consumption by 2015F. The connection fee provides incentives for downstream players to build additional gas distribution networks to increase their penetration rates in China. We believe the amount of connection fee per household will not drop sharply, and that the connection fee system will still exist in the next few years.

Connection fee remains in place for the next few years to motivate gas distributors to increase their gas penetration rates

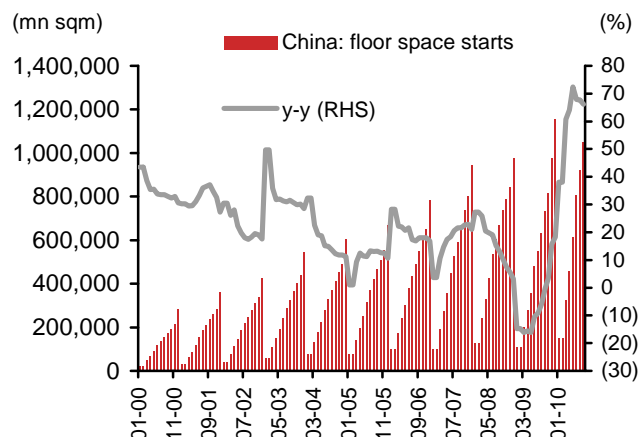
Exhibit 35. China: Natural gas penetration rate 2008



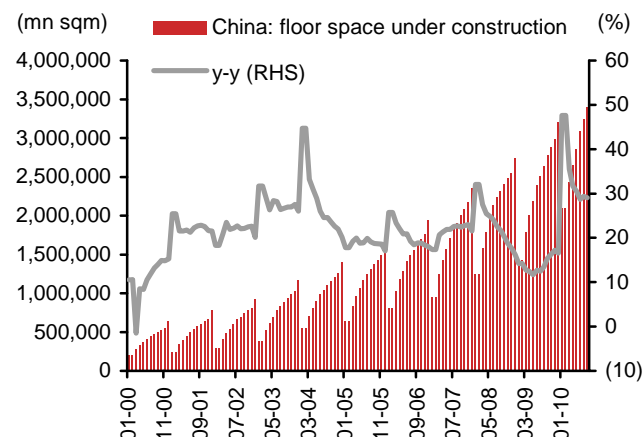
Source: CEIC, Nomura research

Penetration rate = Population with access to gas over Urban population

Heading to 2011F, we expect to see growth in new connections, as property development grows in China.

Exhibit 36. China: floor space starts

Source: CEIC, Nomura research

Exhibit 37. China: floor space under construction

Source: CEIC, Nomura research

In the long run, with increased penetration rates, the connection fee proportion in the revenue structure will gradually drop, in our view. The revenue structure of the gas distributors will become healthier, as more contribution will likely come from the recurring gas sales business, instead of the one-off connection fee income. We believe once the penetration rate reaches about 50%, the government will start to consider abolishing the connection fee system in most cities in China. In our model, we have assumed that by 2017F, around half of China would have abolished the connection fee.

We project by 2017F, with penetration rate reaching ~50% in most cities, half of China will abolish the connection fee system

Changes in accounting treatment; no significant impact to cash flow

Generally, the connection fee is recognized based on a completion method under Hong Kong Accounting Standards, i.e. recognize in accordance to the proportion of completion. This treatment is widely adopted by gas distributors, except for eight projects of ENN Energy, which adopts an amortization method based on the project concession period to recognize the income. Regardless of the accounting treatment (amortisation, deferred income or completion method), we estimate no material impact on the gas distributors. Overall, a lower revenue will be recognized in the income statement, with the balance be treated as deferred income. Cash flow will likely improve slightly, with benefits from tax savings due to the deferral of connection fee recognition.

Policy – 12th Five-Year Plan

Policy support for gas demand

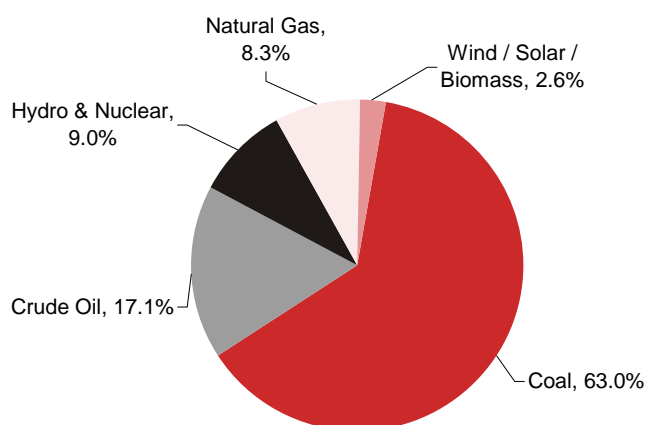
12th Five-Year Plan (FYP) expectations

With increased awareness of greenhouse gas emissions and the usage of clean energy, the Chinese government targets to cut carbon emissions by 40-45% by 2020. Under the 12th FYP, the government targets to raise the natural gas proportion in the primary energy mix from 3.9% in 2009 to 8.3% in 2015. This represents gas demand of about 260bcm by 2015F versus 90bcm in 2009, implying a CAGR of 19.4%, the highest growth rate compared to other energy sources.

Based on our estimates, we expect gas demand to reach 181bcm by 2015F and 289bcm by 2020F. Despite our “less-optimistic” estimates than the government's forecast, we see the government's policy supportive to the gas sector and are confident that our gas demand estimates is achievable, with upside potential.

Government promotes the gas usage in 12th FYP. We expect gas demand to be 181bcm by 2015F and 289bcm by 2020F

Exhibit 38. China: 2015F primary energy mix (NDRC)



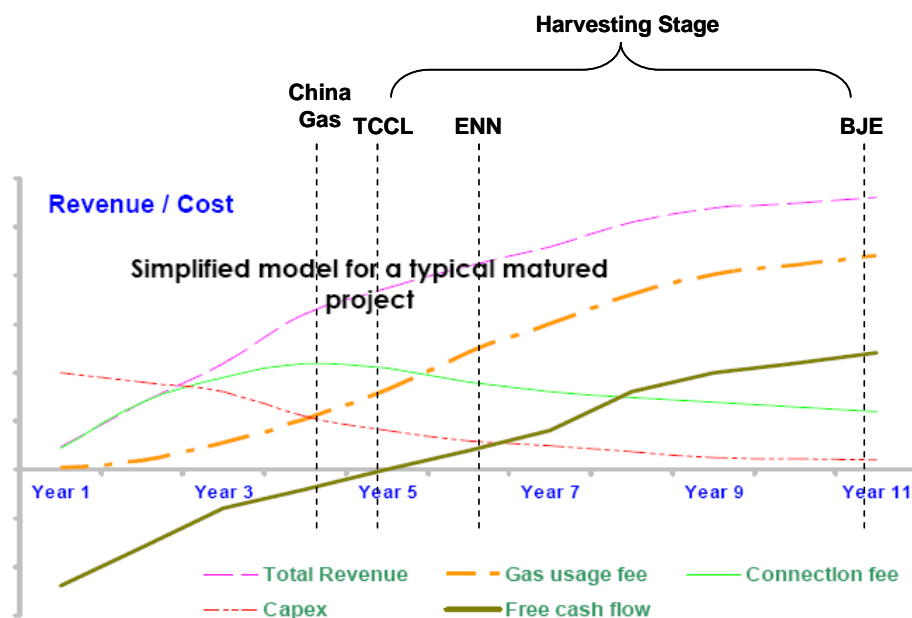
Source: NDRC, Nomura research

Industry consolidation

Size does matter

We believe projects acquisition will still be the main theme of the downstream gas industry in the near term, with gas companies trying to acquire more projects to grow bigger and stronger. Industry consolidation looks inevitable in the long term.

Exhibit 39. Different stages of listed gas companies



Note: CR Gas is still in the asset acquisition phase, which is not included in the comparison

Source: Nomura research

Phase I: Project acquisition / cooperation

The China gas distribution sector is under a project-acquisition / cooperation phase (Phase I), including joint bidding for new projects, joint operation of some midstream pipeline projects and CNG business. Currently, there are around 70-80 medium and large city gas projects that are in the hands of the local governments. We believe in Phase I, these projects will gradually be acquired by city gas companies and we expect many acquisitions to happen over the next five years. However, we do not expect any large scale M&A activities any time soon, as the industry is still facing a low penetration rate. Nonetheless, with gas supply increasing gradually and margins staying stable, we expect city gas companies to witness 20%-plus pa bottom-line growth, still a decent return for distributors, in our view.

In our opinion, all gas distributors in China will actively look to secure new projects in the next few years. However, we believe CR Gas has the biggest opportunity to secure more projects, including medium to large size projects. Leveraging the "China Resources" brand name, the company can acquire directly from third parties to grow its portfolio, or for medium to large size projects (or unprofitable projects), its parent, CR Holdings, can acquire, then improve or restructure the assets before injecting (likely at a discount) them into CR Gas. We also believe Kunlun Energy can benefit from potential asset injections from PetroChina, which has intention to access China's natural gas downstream market. BJE is also likely to be another beneficiary, given its plan to expand outside of Beijing with the help of its SOE status and strong cashflow.

We expect CR Gas, BJE and Kunlun Energy to secure medium- to large-sized projects in Phase I

Phase II: Road to consolidation

Industry consolidation is inevitable in the long run, in our view. We believe any consolidation will take at least five years to happen, during which we believe: 1) organic growth will subside; 2) fewer projects will be available in the market; 3) the penetration rate will likely reach about 40-50%, leading to a potential abolishment of the pipeline connection fee system; 4) gas supply and demand may reach an equilibrium, with potential deregulation for gas prices (both upstream and downstream); and 5) the government intends to have only one operator per province, for reasons of ease of control and economies of scale.

By then, small players would not only lose contributions from the pipeline connection fee, but also bargaining power to obtain low gas prices to remain profitable. At the same time, large gas distributors would seek growth through M&A with small players. As such, we believe size does matter in the long term, as only big players have the means to survive in the market. Among our coverage universe, we believe CR Gas, BJE and Kunlun Energy possess the greatest potential to be major acquirers and survivors in the market, since: 1) we expect them to benefit in near-term M&A activities to grow their size; 2) their SOE status should provide greater bargaining power in negotiating for more preferential gas prices; and 3) their strong balance sheet and cashflow provide more flexibility for consolidation.

We expect CR Gas, BJE and Kunlun Energy to be acquirers and survivors in the markets in long term

Risks

Macro headwinds to the gas sector

CPI concern – Difficulty in wellhead cost pass through?

Based on past records, whenever there was a wellhead price hike, city gas distributors were able to raise the downstream gas tariff by the same magnitude or more. In our view, the government is firm in passing on the wellhead price hike to end users.

As demonstrated in the recent wellhead price hike, the government did not raise the wellhead price substantially despite higher imported gas prices (with the CNPC incurring a loss for every imported gas they sell) and did not request the gas distributors to squeeze their margins. Instead, it adopted a gradual wellhead price increase and allowed the gas distributors to pass on the costs to end users.

We believe the government will follow the same approach in the near term. In addition, owing to China's mild inflation (Nomura estimates 3.6% in 2011F and 4% in 2012F) and the government's supportive stance towards the efficient use of natural gas, passing on the costs should not be difficult, although a time lag is expected. Overall, absolute margins look sustainable but the percentage may see dips. In the longer term, the government will pursue the automatic pass-through mechanism, which helps to minimize gas distributors' margin squeeze while waiting for the local pricing bureau's public hearing.

CPI should not be a concern for gas distributors to pass on the rising wellhead cost

Slowing GDP and industrial production growth

With natural gas shortages over the past few years and competitiveness of natural gas over other types of energy, the sector has been constrained by gas supply and many industrial customers are pending pipeline connections. Therefore, China's gas distribution sector is a "supply-pulled" rather than a "demand-pulled" sector, and any slowdown in GDP or industrial production should not affect distributors' gas sales volume growth materially, in our view. Indeed, the substantial increase in gas supply since this year has allowed distributors to connect and sell more gas to industrial users.

Supply-pulled characteristic insulates China's gas distribution sector from any GDP slowdown impact

Interest rate hike risks?

China is expected to face a rising interest rate environment. Further to the recent interest rate hike of 0.25pp, Nomura's economist expects another 1pp rate hike in 2011F, which may pose additional financing burden to gas distribution companies. Generally, we have already factored in rising interest rates in our assumptions. Among our coverage universe, except for China Gas which we expect to face the biggest adverse impact (a 1% interest rate hike will cause its FY11F net profit to drop 11%, according to our sensitivity analysis), the impact on other gas distributors are immaterial.

Immaterial interest rate hike risks for gas distributors, except for China Gas

Exhibit 40. Interest rate sensitivity analysis

| Company | FY11 Net Gearing (%) | FY11 Effective Interest Rate (%) | FY11 Interest Coverage Ratio | 1% Interest Hike Impact on EPS |
|---------------|----------------------|----------------------------------|------------------------------|--------------------------------|
| CR Gas | cash | 2.5% | na | 2.0% |
| BJE | 3.5% | 4.7% | 6.27 | 2.6% |
| ENN Energy | 29.0% | 6.5% | 5.39 | 2.4% |
| Towngas China | 17.1% | 4.7% | 5.28 | 3.7% |
| China Gas | 69.2% | 4.5% | 3.27 | 11.0% |

Source: Nomura estimates

Stock Picks

BUY CR Gas, BJE and Kunlun Energy

We prefer companies that can benefit from the theme of short-term growth story and are survivors in the long run. Across the gas distribution universe, we favour CR Gas, Beijing Enterprises and Kunlun Energy, which are likely to have more acquisitions opportunities than other players, with the potential to be a market leader in the long term. We downgrade China Gas to REDUCE on uncertainties over LPG margins and phase-out risks, together with the limited growth potential and option dilution risks. We maintain REDUCE on HKCG, given its demanding valuation. We are NEUTRAL on ENN Energy and Towngas China, due to their fair valuations at current price levels, taking into account their growth potential and risk profile.

BUY: CR Gas, Beijing Enterprises and Kunlun Energy

REDUCE: China Gas and HK & China Gas

Why has the sector underperformed in FY10 YTD?

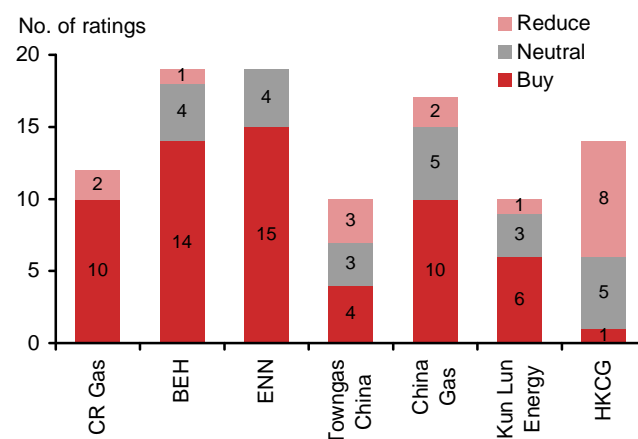
Despite the expected strong fundamentals, the share prices of China gas distribution have not responded positively and have underperformed the market YTD (3.8% vs 5.6% for HSCEI). We believe this was due to: 1) concerns about margin squeeze on wellhead cost pass through; 2) gas supply remains tight in 2010, limiting growth of gas distributors; and 3) side effects to other gas distributors after the bribery news of ENN Energy (source: Beijing Evening Post dated 24 May 2010). We believe the market is over concerned about the sector, as YTD, the P/E valuations are actually falling, meaning the companies are fundamentally improving (able to deliver the earnings), but without the respective share prices movement. In our view, this should provide a good entry opportunity. We expect the share prices of "laggard" players, such as CR Gas and BJE, to recover, given visible growth opportunities supported by the 12th FYP and increased gas supply, with leverage on their own strength across the industry.

Exhibit 41. China gas distributors ytd performance

| | YTD Performance (%) | Market Cap (HK\$m) | Weighted Avg Return (%) |
|---------------------|---------------------|--------------------|-------------------------|
| CR Gas | 3.5 | 21,607 | 0.2 |
| BJE | (5.1) | 60,736 | (1.0) |
| ENN Energy | 21.5 | 25,519 | 1.7 |
| Towngas China | 12.8 | 8,644 | 0.3 |
| China Gas | 4.7 | 16,159 | 0.2 |
| Kunlun Energy | (3.7) | 49,243 | (0.6) |
| HKCG | 6.6 | 135,746 | 2.8 |
| Gas Industry | | | 3.8 |
| HSCEI | | | 5.6 |

Source: Bloomberg, Nomura research

Exhibit 42. China gas distributors: market rating



Source: Bloomberg, Nomura research

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Maintained

BUY

NOMURA

NOMURA INTERNATIONAL (HK) LIMITED

Action

We like China Resources Gas, given near-term value-accretive asset injections by the parent company and direct acquisitions through leveraging its parent's strong platform. We are also positive on the prospect of the company being a consolidator in the long run. In our view, the share price not only understates the value of the existing assets, but also neglects potential asset injections. We reaffirm BUY, with a revised price target of HK\$14.80.

Catalysts

Future asset injections by the parent should be value accretive. Any new projects that go to the parent could also serve as positive catalysts, in our view.

Anchor themes

We are upbeat on China's gas distribution sector, considering: 1) favourable government policies; 2) robust demand growth underpinned by the transition to clean and low-cost energy; 3) stable margins attributable to strong cost pass-through capability; and 4) potential upside from the new energy initiatives.

Long-term market leader: our top pick in the sector

1 Visible growth: parent asset injections, acquisitions

We like CR Gas for its strong, visible growth potential. The company plans to spend around RMB10bn to increase the number of its projects from 41 currently to more than 90 by 2013F, with gas sales seen rising from 5bcm to 9bcm. We expect growth to come through value-accretive asset injections by the parent, as well as third-party acquisitions leveraging the parent's established platform. The growth outlook puts the company on the way to being a major consolidator in the long run, we believe.

2 Size matters: long-term acquirer

The China gas distribution sector is going through a project acquisition phase, and CR Gas is aggressively securing new projects through parent injections and direct acquisitions. Once the acquisition activity has played out, we expect a consolidation process, where the big players consolidate the small participants, leaving just a few big players. Leveraging its parent's support and SOE status, CR Gas will be one of those left standing, we believe.

3 Growth opportunities merit premium valuation

At HK\$11.72, the company is trading at 19.5x FY11F P/E (versus 19.6x for peers). Given its visible growth opportunities, we believe CR Gas merits more of a valuation premium. We believe the current share price not only understates the value of the existing asset portfolio, but also neglects future acquisition growth potential. We reaffirm our BUY call, with our revised price target of HK\$14.8 offering upside potential of 26.3%. CR Gas is our top sector pick for 2011F.

| | |
|---------------------------|--------------------------------------|
| Closing price on 2 Nov | HK\$11.72 |
| Price target | HK\$14.80 (from HK\$14.40) |
| Upside/downside | 26.3% |
| Difference from consensus | 15.2% |
| FY11F net profit (HK\$m) | 1,102 |
| Difference from consensus | 8.4% |
| Source: Nomura | |

Nomura vs consensus

We have factored in the value of future asset injection from parent and the Tianjin project into our price target.

Key financials & valuations

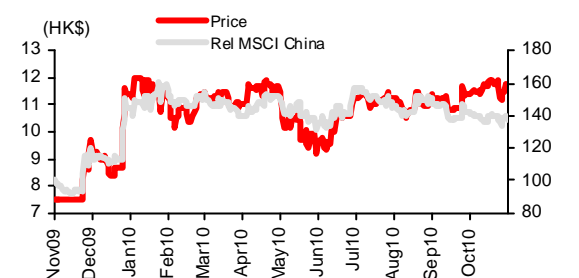
| 31 Dec (HK\$m) | FY09 | FY10F | FY11F | FY12F |
|-----------------------|--------|----------|----------|----------|
| Revenue | 3,747 | 7,006 | 9,993 | 12,488 |
| Reported net profit | 444 | 743 | 1,102 | 1,282 |
| Normalised net profit | 444 | 743 | 1,102 | 1,282 |
| Normalised EPS (HK\$) | 0.31 | 0.46 | 0.60 | 0.70 |
| Norm. EPS growth (%) | (49.6) | 46.0 | 31.4 | 16.4 |
| Norm. P/E (x) | 37.4 | 25.6 | 19.5 | 16.7 |
| EV/EBITDA (x) | 28.0 | 13.7 | 9.0 | 7.5 |
| Price/book (x) | 16.1 | 3.5 | 3.1 | 2.7 |
| Dividend yield (%) | 0.5 | 0.7 | 1.0 | 1.2 |
| ROE (%) | 27.2 | 20.8 | 16.8 | 17.1 |
| Net debt/equity (%) | 48.9 | net cash | net cash | net cash |

Earnings revisions

| | | | |
|---------------------------|------|------|------|
| Previous norm. net profit | 659 | 845 | 991 |
| Change from previous (%) | 12.8 | 30.4 | 29.3 |
| Previous norm. EPS (HK\$) | 0.47 | 0.60 | 0.70 |

Source: Company, Nomura estimates

Share price relative to MSCI China



| | 1m | 3m | 6m |
|--------------------------------------|-------|-------|------------|
| Absolute (HK\$) | 2.6 | 4.5 | 0.3 |
| Absolute (US\$) | 2.7 | 4.6 | 0.5 |
| Relative to Index | (3.7) | (5.4) | (10.1) |
| Market cap (US\$m) | | | 2,769 |
| Estimated free float (%) | | | 0.3 |
| 52-week range (HK\$) | | | 12.00/7.50 |
| 3-mth avg daily turnover (US\$m) | | | 8.82 |
| Stock borrowability | | | Easy |
| Major shareholders (%) | | | |
| China Resources National Corporation | | | 68.1 |

Source: Company, Nomura estimates

Top pick in the sector

Acquisition play

China Resources Gas (CR Gas) is our top pick across the sector. Apart from the strong organic growth of the existing asset portfolio, we believe the company has a visible pipeline for future asset injections from the parent. As we see it, the current share price presents an attractive entry point, since the stock looks to be trading at a discount to the value of its existing asset portfolio, even without considering acquisition growth potential.

Current share price provides attractive entry level

Acquisition pipeline for next 3 years: getting bigger, stronger

CR Gas plans to more than double its number of projects over a three-year horizon, from 41 projects and gas sales of 5bcm currently to >90 projects with gas sales of 9bcm by 2013F. It is targeting to secure new projects through asset injections by the parent and acquisitions from third parties, and in so doing expects to spend some RMB10bn over 2010-12F. Given management's execution ability, we are confident the company will become bigger and stronger over a three-year horizon.

Targeting to invest RMB10bn in more than doubling number of projects on three-year horizon

Exhibit 43. Targeted no. of projects by 2013

| | Project no. |
|------------------------------------|-------------|
| Existing | 32 |
| Acquired in 2H10 | 9 |
| Parent | 30 |
| 3rd Parties | 20 |
| Target projects no. by 2013 | 91 |

Source: Company data, Nomura research

Exhibit 44. Targeted investments for 2010-12F

| Period | Project | Investment (RMBbn) |
|--------------|-------------|--------------------|
| 1H10 | 5 projects | ~1.1 - 1.2 |
| 2H10 | 9 projects | ~1.8 |
| 2010/11 | Tianjin Gas | 2.0 - 2.5 |
| 2011 | | 2.0 - 3.0 |
| 2012 | | 2.0 - 3.0 |
| Total | | ~10.0 |

Source: Company data, Nomura research

30 projects at parent level; gradual, value-accretive injection to CR Gas expected

We believe that the parent of CR Gas, China Resources Holdings (CRH), provides another growth platform for CR Gas. We believe the intention is for CRH to acquire immature projects that are loss-making and projects that are relatively large by CR Gas' current standards, and then restructure them before injecting into CR Gas.

Parent has 30 projects pending injection into CR Gas; sales volume is around 1bcm

Currently, the parent owns 30 projects that have yet to be injected into CR Gas; around half of these are profitable at the moment, according to CR Gas. Among these are some medium-to-large-sized projects, such as Fuzhou at Fujian and Nanchang at Jiangxi. Per CR Gas, Fuzhou and Nanchang are still loss-making and asset injection into CR Gas is targeted only in 2011F and 2012F, respectively. In total, the current gas sales of these 30 projects stand at around 1bcm, which is expected to grow to 2-3bcm by 2013F, according to management.

Looking at previous acquisitions from the parent, the deals were typically done at a discount to CR Gas' and industry-average valuations. We believe future acquisitions will follow the same pattern and hence be value-accretive for CR Gas. According to management, the parent is also in negotiations to acquire some projects. Since we believe that any projects belonging to the parent will ultimately be injected into CR Gas, asset acquisitions by the parent should also have positive implications for CR Gas.

Our view is that the next round of asset injections will likely occur in mid-2011F, given CR Gas acquired nine projects from its parent earlier this year.

Exhibit 45. CR Gas: Projects at parent level

| Projects | Province | Status | Source |
|-----------------------------|----------------|------------------------------|------------------------------|
| Yueyang | Hunan | Established in parent | Company website |
| Guixi | Jiangxi | Established in parent | Company website |
| Jingdezhen | Jiangxi | Established in parent | Company website |
| Dayawan | Guangdong | Established in parent | Company website |
| Heyuan | Guangdong | Established in parent | Company website |
| Jiangmen | Guangdong | Established in parent | Company website |
| Cangzhou | Hebei | Established in parent | Company website |
| Anyang | Henan | Established in parent | Company website |
| Tonghua | Jilin | Operation rights obtained | Company website |
| Hunyuan County (Datong) | Shanxi | Cooperation agreement signed | Company website |
| Tianzhen (Datong) | Shanxi | Cooperation agreement signed | Company website |
| Zuoyun (Datong) | Shanxi | Cooperation agreement signed | Company website |
| Yanggao (Datong) | Shanxi | Cooperation agreement signed | Company website |
| Guanglin (Datong) | Shanxi | Cooperation agreement signed | Company website |
| Lingqiu (Datong) | Shanxi | Cooperation agreement signed | Company website |
| Luqiao Area (Taizhou) | Zhejiang | Established in parent | Company website |
| Nantong | Jiangsu | Cooperation agreement signed | Ministry of Commerce website |
| Panjin | Liaoning | Cooperation agreement signed | Local government website |
| Longchang County (Neijiang) | Sichuan | JV established | Local government website |
| Zizhong County (Neijiang) | Sichuan | JV established | Local government website |
| Chibi | Hubei | Cooperation agreement signed | Cbrx.com |
| Dandong | Liaoning | Cooperation agreement signed | Ddnews.com.cn |
| Haicheng | Liaoning | Cooperation agreement signed | Hcxcw.com |
| Yinchuan | Ningxia | Cooperation agreement signed | Nxein.com |
| Chifeng | Inner Mongolia | Cooperation agreement signed | Chifeng Daily |
| Nanchang | Jiangxi | 49% interest bought | Secutimes.com |
| Fuzhou | Fujian | 49% interest bought | Sina.com |

Source: Nomura research

Acquisition from third parties; leveraging China Resources brand

Aside from parent injections, CR Gas is also targeting to acquire 20 projects from third parties over the next three years. We believe CR Gas is seeking to leverage the China Resources brand and the government's supportive stance towards state-owned enterprises (SOEs) to enhance its relationships with local governments. We think it has an edge over peers in securing new projects. On our estimates, there are around 70-80 medium-sized to large city gas projects still in the hands of local governments. CR Gas's target is to acquire 20-30 of these projects over the long term. In contrast to the parent injections, we expect the third-party acquisitions will be done more along the lines of market value. Still, to maintain strategic relationships with the CR Group (eg, to attract investment by the CR Group to the city), we think local governments may be inclined to offer attractive valuations to CR Gas. We note the company has an IRR hurdle rate of 15% for project acquisitions.

Targeting to acquire 20 projects from third parties over next three years

Exhibit 46. CR Gas: previous acquisitions / injections

| Date | Projects | Consideration | Note | P/E (x) | | |
|-------------|---|---------------|-----------------------|-------------|--------|----------|
| | | | | Acquisition | CR Gas | Industry |
| From Parent | | | | | | |
| 21 Aug 2008 | Chengdu, Fuyang, Huaibei, Linhai, Suzhou, Nanjing and Wuxi | HK\$3,814.8mn | Guaranteed Profit | 15 | 6 | 20 |
| 8 Sep 2009 | Zibo, Yangquan, Xiangfan, Zhenjiang, Yicheng, Qianjiang, Datong | HK\$1,600mn | Guaranteed Profit | 13 | 28 | 22 |
| 13 Sep 2010 | Xiamen, Jining, Suining, Tengzhou, Shifang, Kunshan, Qidong, Gucheng, Hangzhouwan | HK\$2,000mn | Guaranteed Profit | 20 | 24 | 18 |
| Market | | | | | | |
| 9 Jan 2009 | Wuhan | RMB265mn | Not Guaranteed Profit | 61 | 22 | 19 |
| 25 Nov 2009 | Zhengzhou, Hebei | HK\$796.0mn | Not Guaranteed Profit | 10 | 30 | 30 |
| 25 Nov 2009 | Zhengzhou, Hebei | HK\$252.3mn | Not Guaranteed Profit | 9 | 24 | 23 |
| | Zhengzhou Gas Total | HK\$1,048.3mn | | | | |
| 24 Dec 2009 | Chongqing | RMB1,162.8mn | Not Guaranteed Profit | 16 | 34 | 33 |

Source: Nomura estimates

Tianjin Gas: targeting completion end-2010F/early-2011

On 28 June, 2010, CR Gas entered into a cooperation agreement with Tianjin Gas, where the two will form a JV to own and operate city gas projects in Tianjin. CR Gas will have a 49% interest in the JV, while Tianjin Gas will own the rest. Total investment in the JV is slated to be RMB4-5bn, of which CR Gas will be required to contribute around RMB2-2.5bn. The project is at the due diligence stage, with government approval pending. It is targeted to be completed by end-2010 or early-2011. We believe the Tianjin project will have a positive impact on CR Gas: 1) conclusion of the project would underline CR Gas' competitive edge over peers in concluding a large city gas project; 2) in 2009, the gas sales volume of Tianjin Gas was around 1.253bcm — significant in the context of CR Gas's current gas sales of around 5.5bcm; and 3) according to CR Gas, the 2010F profit guidance for the Tianjin project is around HK\$200mn (ie, HK\$98mn on an attributable basis). The RMB2-2.5bn investment required of CR Gas implies a P/E for the deal of 23.9-29.8x, which we find to be comparable to industry valuations. On our estimates, the Tianjin project could add HK\$1.6 per share of value to CR's Gas and we have incorporated 50% of this HK\$1.6 into our price target.

Tianjin deal expected to be completed by end-2010F/early-2011F

Zhengzhou Gas (ZZG): stake increased from 43.18% to 56.87%

On 25 November, 2009, CR Gas announced plans to take an 80% stake in a new JV with Zhengzhou SASAC, which holds 43.18% of ZZG (3928 HK). As at 8 October, 2010, the JV had placed a cash offer and raised its shareholding in ZZG to 56.87%. Per consensus earnings estimates, the acquisition was done at an average P/E valuation of 9-10x — attractive considering CR Gas was trading at 30x FY09 and 24x FY10F P/E — and will contribute FY10F earnings of RMB122.6mn.

Chongqing Gas: large project with strong growth opportunity

On 24 December, 2009, CR Gas announced plans to buy a 25% stake in Chongqing Gas. The Chongqing project is the fourth-largest city gas project in China, with 2.5mn customers and gas sales of 2.1bcm. Currently, Chongqing Gas only services 23 out of 40 districts in Chongqing. CR Gas is very positive on Chongqing Gas' growth potential through expansion to the remaining 17 districts. CR Gas expects the project to enjoy volume growth of 20% (including both organic and expansion growth), with the number of customers seen increasing by 400,000 every year.

CR Gas sees significant growth potential for Chongqing project

Cooperation with CNPC; more certainty on gas supply, less competition for new project acquisitions

CRH (and in turn CR Gas) has entered into a strategic collaboration agreement with China National Petroleum Corporation (CNPC) on 29 June, 2010. Included in the agreement are three main themes: 1) priority for CNPC to supply gas to CRH's city gas projects; 2) non-compete agreement on city gas projects; and 3) potential participation of CNPC's natural gas infrastructure facilities, such as long distance pipelines, by CRH. In our opinion, the agreement not only provides more certainty in terms of gas supply to CR Gas, but lifts concern regarding competition from CNPC in the downstream business (ie, Kunlun Energy and Kunlun Gas, which are under the CNPC umbrella) and provides more mid-stream investment opportunities to CR Gas — opportunities that are not available to CR Gas' peers.

Cooperation with CNPC on securing gas supply, not competing on city gas projects and potential investment in gas infrastructure facilities

In industry consolidation, size matters

China's gas distribution sector is in a project-acquisition phase (Phase I), with the gas companies looking to acquire more projects to grow bigger and stronger. We estimate around 70-80 medium-sized to large city gas projects are in the hands of local governments, and we believe these projects will eventually be acquired by the city gas companies. Further to completion of these acquisitions, it is likely that only small projects will be left on the market. Hence, we expect a flurry of acquisition activity in the next few years.

Leveraging parent's strong platform to become market leader in long run

We believe upon completion of Phase I, the industry will then enter Phase II, ie, industry consolidation. By that time, we expect penetration rates to have reached a level at which connection fee may be abolished and gas prices deregulated. In such a scenario, we think that small companies, of which there are several hundreds currently, would not only lose connection fee income but would be unable to obtain low enough gas prices to remain profitable. Hence, we see such companies becoming acquisition targets. And we believe CR Gas will be one of the major acquirers and survivors, since: 1) it can grow in size through M&A in the short term; 2) SOE status should enhance its bargaining power in price negotiations for gas supplies; and 3) its (together with its parent) strong balance sheet and cash flow provide more flexibility for consolidation.

Benefits from more new gas supply

We see CR Gas being one of the beneficiaries of more gas supply, as some projects under the listco (eg, Kunming and Wuxi) and at the parent level are suffering from supply deficits. Despite higher gas costs from the new sources, the company stated that it will utilise the new gas supply as "supplemental" in the short term, ie, secure the supply when customers are willing to pay a higher price. Longer term, with gas prices likely to be gradually revised up, increased gas supply should bring higher volume growth to the company.

Neutral on higher gas supply in short term; but long-term benefits

Investment concerns

Funding pressure from acquisition / injection pipeline

In our view, funding needs are central to the successful execution of the above pipelines. Per CR Gas, future acquisitions will be funded 50/50 by bank borrowings and shares or bond issuance, with a target of not exceeding a 100% net debt-to-equity ratio. Further to its recent 230mn share issuance, we expect the company to be in net cash position by end-2010 provided no further acquisitions are made in 2010. As such, there appears to be room for CR Gas to use bank borrowings instead of equity financing, at least for the next round of acquisition. On the other hand, by virtue of China Resources' background, CR Gas should have lower financing costs than its industry peers, we believe. According to management, the current effective interest rate charged to the company is around HIBOR + 0.95%, which is only around 1.7%. In addition, with the company utilising HKD as its major bank borrowings, the potential interest rate hike in China likely would not have much impact on the company. We assume the company's effective interest rate is 2.5-3% from 2011F onwards.

No pressure for share issuance in short term, as the company is net cash

Exhibit 47. Interest rate sensitivity analysis

| Company | FY11 Net Gearing (%) | FY11 Effective Interest Rate (%) | FY11 Interest Coverage Ratio | 1% Interest Hike Impact on EPS |
|---------------|----------------------|----------------------------------|------------------------------|--------------------------------|
| CR Gas | cash | 2.5% | na | 2.0% |
| BJE | 3.5% | 4.7% | 6.27 | 2.6% |
| ENN Energy | 29.0% | 6.5% | 5.39 | 2.4% |
| Towngas China | 17.1% | 4.7% | 5.28 | 3.7% |
| China Gas | 69.2% | 4.5% | 3.27 | 11.0% |

Source: Nomura estimates

Wellhead price hike – neutral to positive

According to CR Gas, the June wellhead gas price hike should be neutral or have a slightly positive impact on the company. For commercial and industrial (C&I) customers, which account for >80% of its revenue, we understand CR Gas has raised the gas sales price sufficiently to offset the higher wellhead price. For residential customers, gas prices for some projects are the subject of public hearings by local pricing bureaux that we believe will be finalised soon. Although the residential component of some projects may see price increases falling short of the wellhead price hike, our view is that the price hike for C&I customers should at least fully offset the deficit, with an overall neutral to positive impact on CR Gas.

Valuation

Price target revised at HK\$14.8

Our price target of HK\$14.8 is based on a sum-of-the-parts (SOTP) valuation, of which HK\$12.29 comes from the existing 41 projects and HK\$2.50 from to-be-injected projects. For the to-be-injected projects, we assign a 50% discount to DCF value to reflect uncertainty over the timing and consideration. Note: though our price target incorporates a value for the to-be-injected projects, our earnings estimates do not reflect any earnings from unapproved or unannounced development projects or future acquisitions, or any projects without specified commencement dates. In addition, we have not factored in any future wellhead price hike or downstream tariff hike in our assumptions, as we assume any wellhead price hike could be fully passed through to end-users and a fixed dollar margin maintained.

Acquisition / injection growth could enhance value by HK\$5/share (HK\$3.4 from 30 projects at parent level and HK\$1.6 from Tianjin project), we estimate. We have assigned 50% discount to the value to reflect any uncertainty.

Premium valuation merited; BUY reaffirmed

At HK\$11.72, the stock is trading at 19.5x FY11F P/E, on our estimates, a slight discount to peers' average multiple of 19.6x. We contend that the company merits a larger premium, given visibility on growth through a pipeline of value accretive projects. Excluding the potential acquisitions / injections, our estimated value for the existing 41 projects is HK\$12.29. Hence, in our view, the current share price not only understates the company's existing portfolio of projects but neglects acquisition growth potential. We reaffirm our BUY rating, with our revised price target of HK\$14.8 presenting potential upside of 26.3%.

Current price not only understates existing projects' value but neglects growth potential from acquisitions, in our view

Exhibit 48. CR Gas: SOTP Valuation

| | Method | WACC | Time period | Terminal growth rate | Discount | NAV per share (HK\$) |
|-----------------------------|--------|------|-------------|----------------------|----------|----------------------|
| The projects at listco | DCF | 6.4% | Till 2020 | 0.0% | 0.0% | 12.29 |
| 30 projects at parent | DCF | 6.4% | Till 2035 | No terminal value | 50.0% | 1.70 |
| Tianjin project | DCF | 6.4% | Till 2035 | No terminal value | 50.0% | 0.80 |
| NAV per share (HK\$) | | | | | | 14.80 |

Note: We assume 41 projects, beginning in 2006, and operational rights lasting for 30 years

Source: Nomura estimates

Risks to our investment view

We have a positive view on the company's overall operation, but are wary of a slower-than-expected new connection and gas sales growth. Meanwhile, the value of future asset injections could be hurt by higher-than-expected investment considerations, in our view. In addition, for any wellhead price hike, it may take some time for the price increase to be passed on, which could hit the bottom line.

Macro risk and difficulty in realising value of new projects until price is paid

Exhibit 49. CR Gas: DCF-based valuation of existing projects at the listco

| CHINA RESOURCES GAS | | | | | | | | | | | |
|---|---------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Discounted Cash Flow Model | | | | | | | | | | | |
| HK\$ mn | 2011F | 2012F | 2013F | 2014F | 2015F | 2016F | 2017F | 2018F | 2019F | 2020F | 2021F |
| Free Cash Flow to the Firm | | | | | | | | | | | |
| Earnings Before Interest and Taxes (EBIT) | 1,748 | 2,040 | 2,370 | 2,651 | 2,960 | 3,239 | 2,746 | 2,955 | 3,155 | 3,342 | 3,546 |
| Taxes on EBIT: | | | | | | | | | | | |
| Add: Income taxes from income statement | 444 | 516 | 592 | 662 | 741 | 814 | 696 | 751 | 805 | 857 | 913 |
| Add: Tax shield on interest expenses | 22 | 29 | 42 | 50 | 57 | 63 | 69 | 75 | 80 | 86 | 92 |
| Less: Tax on Interest Income | (29) | (35) | (42) | (49) | (58) | (68) | (79) | (87) | (97) | (107) | (118) |
| Less: Tax on non-operating income | - | - | - | - | - | - | - | - | - | - | - |
| Total Taxes on EBIT | (437) | (510) | (592) | (663) | (740) | (810) | (687) | (739) | (789) | (835) | (886) |
| Minority Interest | (240) | (280) | (321) | (359) | (402) | (442) | (379) | (409) | (438) | (466) | (497) |
| Change in deferred income taxes | - | - | - | - | - | - | - | - | - | - | - |
| Goodwill Amortization | - | - | - | - | - | - | - | - | - | - | - |
| Dividend from JCE and associates | 9 | 11 | 14 | 17 | 19 | 22 | 24 | 27 | 29 | 31 | 32 |
| Net Operating Profits After Taxes, NOPAT | 1,079 | 1,261 | 1,471 | 1,645 | 1,837 | 2,009 | 1,705 | 1,834 | 1,957 | 2,071 | 2,195 |
| Depreciation & Amortization (except goodwill) | 287 | 366 | 450 | 527 | 600 | 671 | 739 | 805 | 868 | 931 | 993 |
| Net Change in Working Capital | 96 | 318 | 158 | 30 | (48) | (64) | (151) | (209) | (259) | (323) | (362) |
| Net Capital Expenditures | (1,323) | (1,720) | (1,548) | (1,424) | (1,412) | (1,345) | (1,306) | (1,231) | (1,217) | (1,199) | (1,197) |
| Free Cash Flows to the Firm (FCFF) | 140 | 224 | 530 | 778 | 976 | 1,271 | 988 | 1,200 | 1,349 | 1,480 | 1,628 |
| Key Assumptions | | | | | | | | | | | |
| Risk-free rate | 2.5% | | | | | | | | | | |
| Beta | 0.72 | | | | | | | | | | |
| Market risk premium (rm - rf) | 7.5% | | | | | | | | | | |
| Cost of Equity (re) | 7.9% | | | | | | | | | | |
| Cost of Preferred Equity (rp) | 0.0% | | | | | | | | | | |
| Cost of Debt | 2.5% | | | | | | | | | | |
| Effective Tax Rate | 25.0% | | | | | | | | | | |
| Market Value Preferred Stock/Capital Ratio | 0.0% | | | | | | | | | | |
| Market Value D/Capital Ratio | 25.0% | | | | | | | | | | |
| Weight Average Cost of Capital (WACC) | 6.4% | | | | | | | | | | |
| Terminal Growth rate | 0.0% | | | | | | | | | | |
| Discounted Free Cash Flow Valuation | | | | | | | | | | | |
| PV of FCFF during 2011-20 | 5,909 | | | | | | | | | | |
| Continuing value based on cash flows beyond Year 2020 | 13,703 | | | | | | | | | | |
| Total Enterprise Value (Operating Value) | 19,612 | | | | | | | | | | |
| Add: Excess Cash & Non-operating Investments | 6,936 | | | | | | | | | | |
| Total Firm Value | 26,548 | | | | | | | | | | |
| Equity Valuation | | | | | | | | | | | |
| Total Firm Value | 26,548 | | | | | | | | | | |
| Less: Value of Interest Bearing Debt | 4,037 | | | | | | | | | | |
| Less: Value of Preferred Stock | - | | | | | | | | | | |
| Value of Common Equity | 22,511 | | | | | | | | | | |
| Number of Share Outstanding (mn) | 1,831 | | | | | | | | | | |
| Equity Value per share (HK\$) | 12.29 | | | | | | | | | | |

Sensitivity table 1

---Terminal Growth Rate---

| | 0.00% | 0.25% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% | 1.75% |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|
| 6.00% | 13.16 | 13.55 | 13.96 | 14.42 | 14.92 | 15.47 | 16.09 | 16.78 |
| 6.25% | 12.60 | 12.94 | 13.32 | 13.72 | 14.17 | 14.66 | 15.20 | 15.80 |
| 6.50% | 12.08 | 12.39 | 12.72 | 13.09 | 13.49 | 13.93 | 14.41 | 14.94 |
| 6.75% | 11.60 | 11.88 | 12.18 | 12.51 | 12.87 | 13.26 | 13.69 | 14.16 |
| 7.00% | 11.15 | 11.41 | 11.68 | 11.98 | 12.30 | 12.65 | 13.04 | 13.45 |
| 7.25% | 10.74 | 10.97 | 11.22 | 11.49 | 11.78 | 12.10 | 12.44 | 12.82 |
| 7.50% | 10.35 | 10.57 | 10.80 | 11.04 | 11.31 | 11.59 | 11.90 | 12.24 |
| 7.75% | 10.00 | 10.19 | 10.40 | 10.62 | 10.86 | 11.12 | 11.40 | 11.71 |
| 8.00% | 9.66 | 9.84 | 10.03 | 10.24 | 10.46 | 10.69 | 10.94 | 11.22 |
| 8.25% | 9.35 | 9.51 | 9.69 | 9.88 | 10.08 | 10.29 | 10.52 | 10.77 |
| 8.50% | 9.06 | 9.21 | 9.37 | 9.54 | 9.72 | 9.92 | 10.13 | 10.36 |
| 8.75% | 8.78 | 8.92 | 9.07 | 9.23 | 9.40 | 9.58 | 9.77 | 9.97 |
| 9.00% | 8.52 | 8.65 | 8.79 | 8.93 | 9.09 | 9.25 | 9.43 | 9.62 |
| 9.25% | 8.28 | 8.40 | 8.52 | 8.66 | 8.80 | 8.95 | 9.11 | 9.29 |
| 9.50% | 8.04 | 8.16 | 8.27 | 8.40 | 8.53 | 8.67 | 8.82 | 8.98 |
| 9.75% | 7.83 | 7.93 | 8.04 | 8.15 | 8.28 | 8.41 | 8.54 | 8.69 |
| 10.00% | 7.62 | 7.72 | 7.82 | 7.93 | 8.04 | 8.16 | 8.29 | 8.42 |
| 10.25% | 7.42 | 7.51 | 7.61 | 7.71 | 7.81 | 7.92 | 8.04 | 8.17 |

Source: Nomura estimates

Exhibit 50. CR Gas: DCF-based valuation of 30 projects at the parent level

| CHINA RESOURCES GAS | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------|---------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| POTENTIAL PROJECTS FROM PARENT - 30 PROJECTS | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Company Guidance | | | | | | | | | | | | | | | As of FY10 | | | | | | | | | | | | | | | | |
| Gas sales (mm m3) - Gross | | | | | | | | | | | | | | | 1,000 | | | | | | | | | | | | | | | | |
| Key Assumptions | | | | | | | | | | | | | | | WACC | | | | | | | | | | | | | | | | |
| Consideration (HK\$ mn) | | | | | | | | | | | | | | | 2,936 | | | | | | | | | | | | | | | | |
| Average connectable household per project (mm) | | | | | | | | | | | | | | | 0.5 | | | | | | | | | | | | | | | | |
| Assumed penetration rate (%) | | | | | | | | | | | | | | | 25.0% | | | | | | | | | | | | | | | | |
| Key Metrics | | | | | | | | | | | | | | | WACC | | | | | | | | | | | | | | | | |
| Weighted Average Cost of Capital (WACC) | | | | | | | | | | | | | | | 6.4% | | | | | | | | | | | | | | | | |
| Terminal Growth rate | | | | | | | | | | | | | | | 0.0% | | | | | | | | | | | | | | | | |
| Key Metrics | 2010F | 2011F | 2012F | 2013F | 2014F | 2015F | 2016F | 2017F | 2018F | 2019F | 2020F | 2021F | 2022F | 2023F | 2024F | 2025F | 2026F | 2027F | 2028F | 2029F | 2030F | 2031F | 2032F | 2033F | 2034F | 2035F | 2036F | 2037F | 2038F | 2039F | 2040F |
| Gas Sales business | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Gas sales (mm m3) - Gross | 1,000 | 1,250 | 1,625 | 1,950 | 2,243 | 2,542 | 2,824 | 3,085 | 3,323 | 3,537 | 3,714 | 3,900 | 4,095 | 4,299 | 4,514 | 4,740 | 4,977 | 5,226 | 5,487 | 5,762 | 6,050 | 6,352 | 6,670 | 7,003 | 7,353 | 7,721 | 8,107 | 8,502 | 8,906 | 9,319 | 9,741 |
| Growth rate (%) | | 25.0% | 30.0% | 20.0% | 15.0% | 13.3% | 11.1% | 9.3% | 7.7% | 6.4% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% |
| Tariff (HK\$m3) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Revenue (HK\$ mn) | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 | 2,53 |
| Cost of Equity (te) | 2,528 | 3,160 | 4,108 | 4,930 | 5,689 | 6,425 | 7,139 | 7,800 | 8,402 | 8,942 | 9,389 | 9,858 | 10,351 | 10,869 | 11,412 | 11,983 | 12,582 | 13,211 | 13,872 | 14,565 | 15,293 | 16,058 | 16,861 | 17,704 | 18,589 | 19,519 | 20,487 | 21,494 | 22,539 | 23,623 | |
| Average connectable household per project (mm) | 536 | 671 | 873 | 1,048 | 1,208 | 1,372 | 1,526 | 1,673 | 1,802 | 1,918 | 2,014 | 2,115 | 2,221 | 2,332 | 2,448 | 2,571 | 2,699 | 2,834 | 2,976 | 3,124 | 3,281 | 3,445 | 3,617 | 3,798 | 3,988 | 4,187 | 4,394 | 4,608 | 4,829 | 5,056 | 5,289 |
| GPM (%) | 21.2% | 21.2% | 21.3% | 21.3% | 21.3% | 21.3% | 21.4% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% |
| Connection Fee Business | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Connectable households (mm) | 15 | 15 | 16 | 16 | 17 | 17 | 18 | 18 | 18 | 19 | 20 | 21 | 21 | 22 | 23 | 23 | 24 | 25 | 26 | 26 | 27 | 28 | 29 | 30 | 30 | 31 | 31 | 32 | 33 | 34 | 35 |
| Penetration rate (%) | 25.0% | 26.7% | 28.5% | 30.5% | 32.5% | 34.7% | 37.1% | 39.6% | 42.3% | 45.2% | 48.2% | 51.5% | 55.0% | 58.8% | 59.8% | 60.8% | 61.8% | 62.8% | 63.8% | 64.8% | 65.8% | 66.8% | 67.8% | 68.8% | 69.8% | 70.8% | 71.8% | 72.8% | 73.8% | 74.8% | 75.8% |
| Connected households (mm) | 4 | 4 | 5 | 5 | 5 | 6 | 7 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 16 | 17 | 18 | 19 | 20 | 21 | 22 | 23 | 24 | 25 | 26 | 27 | 28 | 29 |
| New connections (mm) | 0.45 | 0.38 | 0.41 | 0.45 | 0.50 | 0.55 | 0.60 | 0.66 | 0.73 | 0.80 | 0.88 | 0.97 | 1.07 | 1.18 | 1.30 | 1.42 | 1.54 | 1.66 | 1.78 | 1.90 | 2.02 | 2.14 | 2.26 | 2.38 | 2.50 | 2.62 | 2.74 | 2.86 | 2.98 | 3.10 | 3.22 |
| Connection fee per household (HK\$) | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 |
| Overall | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Revenue (HK\$ mn) | 3,795 | 4,207 | 5,260 | 6,197 | 7,063 | 7,958 | 8,825 | 9,727 | 9,422 | 10,084 | 10,623 | 11,216 | 11,845 | 12,512 | 11,412 | 11,983 | 12,582 | 13,211 | 13,872 | 14,565 | 15,293 | 16,058 | 16,861 | 17,704 | 18,589 | 19,519 | 20,487 | 21,494 | 22,539 | 23,623 | |
| Gross profit (HK\$ mn) | 1,227 | 1,247 | 1,507 | 1,748 | 1,975 | 2,215 | 2,454 | 2,893 | 2,863 | 2,935 | 2,982 | 3,042 | 3,295 | 3,042 | 2,448 | 2,571 | 2,699 | 2,834 | 2,976 | 3,124 | 3,281 | 3,445 | 3,617 | 3,798 | 3,988 | 4,187 | 4,394 | 4,608 | 4,829 | 5,056 | |
| GPM (%) | 32.4% | 29.6% | 28.6% | 28.2% | 28.0% | 27.8% | 27.8% | 25.0% | 25.1% | 25.2% | 25.4% | 25.5% | 25.7% | 25.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% |
| SG&A as % of Revenue | (827) | (577) | (711) | (794) | (891) | (988) | (1,090) | (1,084) | (1,170) | (1,250) | (1,319) | (1,393) | (1,471) | (1,554) | (1,417) | (1,488) | (1,563) | (1,641) | (1,723) | (1,809) | (1,900) | (1,995) | (2,094) | (2,199) | (2,309) | (2,424) | (2,544) | (2,669) | (2,799) | (2,934) | |
| EBIT (HK\$ mn) | 700 | 669 | 705 | 982 | 1,084 | 1,228 | 1,359 | 1,099 | 1,193 | 1,285 | 1,374 | 1,469 | 1,571 | 1,681 | 1,031 | 1,082 | 1,136 | 1,193 | 1,253 | 1,315 | 1,381 | 1,450 | 1,523 | 1,599 | 1,679 | 1,763 | 1,851 | 1,941 | 2,034 | 2,130 | |
| EBIT margin (%) | 18.5% | 15.9% | 15.1% | 15.4% | 15.3% | 15.4% | 15.4% | 12.6% | 12.7% | 12.8% | 12.9% | 13.1% | 13.3% | 13.4% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% |
| Tax rate (%) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| EBIT(-)/ (HK\$ mn) | 560 | 502 | 537 | 714 | 813 | 900 | 1,018 | 825 | 885 | 964 | 1,030 | 1,101 | 1,178 | 1,261 | 773 | 812 | 862 | 910 | 940 | 987 | 1,036 | 1,088 | 1,142 | 1,199 | 1,259 | 1,322 | 1,388 | 1,456 | 1,526 | 1,599 | |
| Depreciation (HK\$ mn) | 40 | 58 | 92 | 122 | 149 | 174 | 197 | 218 | 238 | 258 | 278 | 298 | 318 | 338 | 358 | 378 | 398 | 418 | 438 | 458 | 478 | 498 | 518 | 538 | 558 | 578 | 598 | 618 | 638 | 658 | |
| CAPEX (HK\$ mn) | (1,000) | (900) | (800) | (700) | (600) | (500) | (400) | (300) | (200) | (100) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) | (0) |
| NWC (HK\$ mn) | (340) | (111) | (111) | (136) | (312) | (484) | (655) | (543) | (633) | (722) | (808) | (889) | (996) | (1,099) | (631) | (690) | (750) | (813) | (878) | (945) | (1,014) | (1,086) | (1,160) | (1,237) | (1,317) | (1,400) | (1,486) | (1,574) | (1,664) | (1,756) | |
| Accumulated CAPEX | (1,000) | (1,900) | (2,700) | (3,400) | (4,050) | (4,650) | (5,200) | (5,700) | (6,200) | (6,700) | (7,200) | (7,700) | (8,200) | (8,700) | (9,200) | (9,700) | (10,200) | (10,700) | (11,200) | (11,700) | (12,200) | (12,700) | (13,200) | (13,700) | (14,200) | (14,700) | (15,200) | (15,700) | (16,200) | (16,700) | (17,200) |
| WACC (%) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| NPV (HK\$ mn) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| NPV per share (HK\$) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

Exhibit 51. CR Gas: DCF-based valuation of Tianjin project

| CHINA RESOURCES GAS | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|--|-------------------------------------|-------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|--|
| TIANJIN PROJECTS | | | | | | | | | | | | | | As of FY09 | | | | | | | | | | | | | | |
| Company Guidance | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Gas sales (mm m3) - Gross | | | | | | | | | | | | | | 1,250 | | | | | | | | | | | | | | |
| Share (%) | | | | | | | | | | | | | | 49.0% | | | | | | | | | | | | | | |
| Gas sales (mm m3) - Attributable | | | | | | | | | | | | | | 613 | | | | | | | | | | | | | | |
| Key Assumptions | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Consideration (HK\$ mn) | | | | | | | | | | | | | | 2,250 | | | | | | | | | | | | | | |
| Average connectable household per project (mn) | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Assumed penetration rate (%) | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Key Metrics | | 2010F | 2011F | 2012F | 2013F | 2014F | 2015F | 2016F | 2017F | 2018F | 2019F | 2020F | 2021F | 2022F | 2023F | 2024F | 2025F | 2026F | 2027F | 2028F | 2029F | 2030F | 2031F | 2032F | 2033F | 2034F | 2035F | |
| | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Gas Sales business | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Volume (mm m3) | 1,250 | 1,563 | 2,031 | 2,438 | 2,803 | 3,177 | 3,530 | 3,857 | 4,154 | 4,421 | 4,642 | 4,875 | 5,118 | 5,374 | 5,643 | 5,925 | 6,221 | 6,532 | 6,859 | 7,202 | 7,562 | 7,940 | 8,337 | 8,754 | 9,192 | 9,651 | |
| | Gas sales (mm m3) - Gross | 1,250 | 1,563 | 2,031 | 2,438 | 2,803 | 3,177 | 3,530 | 3,857 | 4,154 | 4,421 | 4,642 | 4,875 | 5,118 | 5,374 | 5,643 | 5,925 | 6,221 | 6,532 | 6,859 | 7,202 | 7,562 | 7,940 | 8,337 | 8,754 | 9,192 | 9,651 | |
| | Gas sales (mm m3) - Attributable | 613 | 766 | 996 | 1,226 | 1,456 | 1,686 | 1,916 | 2,146 | 2,376 | 2,606 | 2,836 | 3,066 | 3,296 | 3,526 | 3,756 | 3,986 | 4,216 | 4,446 | 4,676 | 4,906 | 5,136 | 5,366 | 5,596 | 5,826 | 6,056 | | |
| | Growth rate (%) | 25.0% | 25.0% | 30.0% | 20.0% | 15.0% | 13.3% | 11.1% | 9.3% | 7.7% | 6.4% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | | |
| | Penetration rate (%) | 47.8% | 48.8% | 49.8% | 50.8% | 51.8% | 52.8% | 53.8% | 54.8% | 55.8% | 56.8% | 57.8% | 58.8% | 59.8% | 60.8% | 61.8% | 62.8% | 63.8% | 64.8% | 65.8% | 66.8% | 67.8% | 68.8% | 69.8% | 70.8% | 71.8% | 72.8% | |
| | Connected households (mn) | 1,96 | 2,06 | 2,17 | 2,28 | 2,39 | 2,51 | 2,63 | 2,76 | 2,90 | 3,04 | 3,19 | 3,34 | 3,50 | 3,66 | 3,72 | 3,78 | 3,84 | 3,90 | 3,96 | 4,02 | 4,08 | 4,14 | 4,20 | 4,26 | 4,32 | 4,38 | |
| | New connections (mn) | 0.10 | 0.10 | 0.11 | 0.11 | 0.11 | 0.12 | 0.12 | 0.13 | 0.13 | 0.14 | 0.15 | 0.15 | 0.16 | 0.17 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | |
| | Connection fee per household (HK\$) | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | 2,792 | - | - | - | - | - | - | - | - | - | - | - | - | |
| | Revenue (HK\$ mn) | - | 282 | 284 | 307 | 320 | 333 | 347 | 361 | 375 | 389 | 403 | 417 | 431 | 445 | 459 | 473 | 487 | 501 | 515 | 529 | 543 | 557 | 571 | 585 | 599 | 613 | |
| | Gross profit (HK\$ mn) | - | 155 | 162 | 169 | 176 | 183 | 191 | 199 | 207 | 215 | 223 | 231 | 239 | 247 | 255 | 263 | 271 | 279 | 287 | 295 | 303 | 311 | 319 | 327 | 335 | 343 | |
| | GPM (%) | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | 55.0% | |
| Overall | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Revenue (HK\$ mn) | 3,160 | 4,232 | 5,629 | 6,469 | 7,406 | 8,364 | 9,270 | 9,930 | 10,690 | 11,373 | 11,940 | 12,536 | 13,160 | 13,816 | 14,265 | 14,979 | 15,727 | 16,514 | 17,340 | 18,207 | 19,117 | 20,073 | 21,076 | 22,130 | 23,237 | 24,399 | |
| | Gross profit (HK\$ mn) | 670 | 903 | 1,253 | 1,480 | 1,686 | 1,898 | 2,099 | 2,191 | 2,356 | 2,506 | 2,630 | 2,790 | 2,897 | 3,041 | 3,060 | 3,213 | 3,374 | 3,543 | 3,720 | 3,906 | 4,101 | 4,306 | 4,521 | 4,747 | 4,985 | 5,234 | |
| | GPM (%) | 21.2% | 23.5% | 23.1% | 22.9% | 22.8% | 22.7% | 22.6% | 22.1% | 22.0% | 22.0% | 22.0% | 22.0% | 22.0% | 22.0% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | |
| | SG&A (HK\$ mn) | (440) | (581) | (724) | (820) | (935) | (1,039) | (1,151) | (1,233) | (1,329) | (1,413) | (1,483) | (1,557) | (1,635) | (1,716) | (1,772) | (1,860) | (1,953) | (2,051) | (2,154) | (2,261) | (2,370) | (2,483) | (2,619) | (2,749) | (2,868) | (3,009) | |
| | SG&A as % of Revenue | 13.9% | 13.7% | 13.5% | 12.6% | 12.6% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | 12.4% | |
| | EBIT (HK\$ mn) | 200 | 413 | 519 | 651 | 752 | 859 | 947 | 987 | 1,029 | 1,093 | 1,147 | 1,203 | 1,263 | 1,325 | 1,288 | 1,353 | 1,420 | 1,491 | 1,566 | 1,644 | 1,726 | 1,813 | 1,903 | 1,999 | 2,093 | 2,203 | |
| | EBIT margin (%) | 7.3% | 9.8% | 9.6% | 10.1% | 10.1% | 10.3% | 10.2% | 9.8% | 9.8% | 9.8% | 9.8% | 9.6% | 9.6% | 9.6% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | 9.0% | |
| | Tax rate (%) | 20.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | |
| | EBIT(1-t) (HK\$ mn) | 164 | 310 | 389 | 488 | 564 | 644 | 710 | 718 | 771 | 820 | 860 | 903 | 947 | 894 | 866 | 1,015 | 1,065 | 1,119 | 1,174 | 1,233 | 1,296 | 1,360 | 1,428 | 1,499 | 1,574 | 1,653 | |
| | Depreciation (HK\$ mn) | 20 | 30 | 49 | 66 | 81 | 94 | 105 | 115 | 125 | 135 | 145 | 155 | 165 | 175 | 185 | 195 | 205 | 215 | 225 | 235 | 245 | 255 | 265 | 275 | 285 | 295 | |
| | CAPEX (HK\$ mn) | (500) | (500) | (450) | (400) | (350) | (300) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | (250) | |
| | NWCF (HK\$ mn) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | |
| | FCF | (160) | (12) | (12) | 154 | 295 | 438 | 565 | 583 | 646 | 705 | 755 | 808 | 862 | 919 | 901 | 960 | 1,020 | 1,084 | 1,149 | 1,218 | 1,290 | 1,365 | 1,443 | 1,524 | 1,609 | 1,698 | |
| | Accumulated CAPEX | (500) | (1,450) | (1,850) | (1,850) | (2,200) | (2,500) | (2,750) | (3,000) | (3,250) | (3,500) | (3,750) | (4,000) | (4,250) | (4,500) | (4,750) | (5,000) | (5,250) | (5,500) | (5,750) | (6,000) | (6,250) | (6,500) | (6,750) | (7,000) | (7,250) | (7,500) | |
| | WACC (%) | 6.4% | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | NPV (HK\$ mn) | 2,212 | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | NPV per share (HK\$) - Gross | 1.6 | | | | | | | | | | | | | | | | | | | | | | | | | | |

Exhibit 52. CR Gas: project details (I)

| | Project | Province | Incorporation date | Stake held (%) | Business | Population (mn) | Connected Households - 1H10 | Installed Capacity (m3/day) - 1H10 | No. of CNG stations - 1H10 |
|--|------------------|----------|--------------------|----------------|--------------------------------------|-----------------|-----------------------------|------------------------------------|----------------------------|
| Acquired in 2008 from CR Holding (7 projects) | | | | | | | | | |
| 1 | Chengdu | Sichuan | 2005 | 36 | pipled gas, CNG | 12.9 | 1,698,166 | 1,602,176 | 3 |
| 2 | Wuxi | Jiangsu | 2005 | 50 | pipled gas, bottled LPG and CNG | 6.2 | 593,109 | 6,365,000 | 6 |
| 3 | Suzhou | Jiangsu | 2003 | 70 | pipled gas and bottled LPG | 6.3 | 128,897 | 715,000 | - |
| 4 | Nanjing | Jiangsu | 1999 | 80 | CNG | 6.3 | - | - | 11 |
| 5 | Fuyang | Zhejiang | 2005 | 50 | pipled gas and bottled LPG | 0.6 | 45,761 | 60,000 | - |
| 6 | HuaiBei | Anhui | 2006 | 60 | pipled gas | 2.2 | 133,999 | 50,000 | 2 |
| 7 | Linhai | Zhejiang | 1995 | 100 | pipled LPG | 1.2 | 26,479 | 12,000 | - |
| | Sub-total | | | | | 35.7 | 2,626,411 | 8,804,176 | 22 |
| Acquired in 2009 from CR Holding (7 projects) | | | | | | | | | |
| 8 | Zhenjiang | Jiangsu | 2006 | 45 | pipled natural gas, bottled LPG, CNG | 2.7 | 157,325 | 630,000 | 2 |
| 9 | Zibo | Shandong | 2007 | 46 | pipled natural gas and/or other gas | 4.2 | 212,819 | 500,000 | 1 |
| 10 | Xiangfan | Hubei | 2007 | 71 | pipled natural gas, CNG | 5.9 | 93,851 | 300,000 | 5 |
| 11 | Datong | Shanxi | 2004 | 75 | pipled natural gas, CNG | 3.2 | 217,023 | 265,000 | 3 |
| 12 | Yangquan | Shanxi | 2007 | 75 | pipled natural gas, CNG | 1.3 | 1,069 | 80,000 | 4 |
| 13 | Yicheng | Hubei | 2002 | 100 | pipled natural gas, CNG | 0.6 | 10,628 | 41,317 | 1 |
| 14 | Qianjiang | Hubei | 2003 | 100 | pipled natural gas | 1.0 | 57,467 | 29,000 | - |
| | Sub-total | | | | | 18.9 | 750,182 | 1,845,317 | 16 |
| Acquired in 2009 from the open market (13 projects) | | | | | | | | | |
| 15 | Wuhan | Hubei | 2002 | 51 | pipled natural gas | 9.1 | 54,679 | 283,000 | 1 |
| 16 | Kunming | Yunnan | 2009 | 64 | pipled natural gas/other gases | 6.3 | 18,768 | 111,000 | - |
| 17 | Tongzhou | Jiangsu | 2009 | 70 | pipled natural gas/other gases | 1.2 | 9,906 | 25,000 | - |
| 18 | Hongdong | Shanxi | 2009 | 51 | pipled natural gas/other gases | 0.7 | 5,146 | 100,000 | 1 |
| 19 | Jinan | Shandong | 2009 | 100 | pipled natural gas | 6.7 | - | 160,000 | - |
| 20 | Zaoyang | Hubei | 2009 | 100 | pipled natural gas | 1.1 | 1,531 | 6,000 | 1 |
| 21 | Yingtian | Jiangxi | 2009 | 100 | pipled natural gas | 1.1 | 5,255 | 940 | - |
| 22 | Luzhou | Sichuan | 2003 | 40 | pipled natural gas | 5.0 | 179,218 | 145,000 | 3 |
| 23 | Hengshui | Hebei | 2009 | 95 | pipled natural gas | 4.4 | 5,539 | 55,000 | - |
| 24 | Yutai | Shandong | 2009 | 100 | pipled natural gas | 0.5 | - | - | - |
| 25 | Huozhou | Shanxi | 2009 | 70 | pipled natural gas and/or other gas | 0.3 | 1,604 | 144,000 | - |
| 26 | Yangqu | Shanxi | 2009 | 65 | pipled natural gas and/or other gas | 0.1 | - | - | - |
| 27 | Yanzhou | Shandong | 2009 | 70 | pipled natural gas and/or other gas | 0.6 | - | - | - |
| | Sub-total | | | | | 37.1 | 281,646 | 1,029,940 | 6 |

Source: Company data, Nomura estimates

Exhibit 53. CR Gas: project details (II)

| | Project | Province | Incorporation date | Stake held (%) | Business | Population (mn) | Connected Households - 1H10 | Installed Capacity (m3/day) - 1H10 | No. of CNG stations - 1H10 |
|---|------------------|--------------|--------------------|----------------|--|-----------------|-----------------------------|------------------------------------|----------------------------|
| Acquired in 2010 from the open market (5 projects) | | | | | | | | | |
| 28 | Chongqing | Municipality | 1995 | 25 | pipled natural gas, CNG | 28.6 | 2,409,276 | 3,280,000 | 5 |
| 29 | Jiangning | Jiangsu | 2010 | 49 | pipled natural gas | 0.3 | 141,584 | 55,000 | - |
| 30 | Yibin | Sichuan | 2010 | 50 | pipled natural gas, CNG | 5.3 | 106,224 | 93,000 | 4 |
| 31 | Neijiang | Sichuan | 2010 | 50 | pipled natural gas, CNG | 4.3 | 113,092 | 40,000 | 2 |
| 32 | Fengcheng | Liaoning | 2010 | 100 | greenfield | 0.6 | - | - | - |
| | Sub-total | | | | | 39.1 | 2,770,176 | 3,468,000 | 11 |
| Acquired in 2010 from CR Holding (9 projects) | | | | | | | | | |
| 33 | Xiamen | Fujian | 2007 | 49 | pipled natural gas and/or other gas, bottled LPG, LPG stations | 1.8 | 276,138 | 457,000 | 2 |
| 34 | Jining | Shandong | 2007 | 51 | pipled natural gas, CNG | 8.3 | 170,623 | 110,750 | 1 |
| 35 | Suining | Sichuan | 1993 | 50 | pipled natural gas, CNG | 3.9 | 131,962 | 58,000 | 4 |
| 36 | Tengzhou | Shandong | 2008 | 70 | pipled natural gas and/or other gas, CNG | 1.7 | 71,453 | 150,000 | 2 |
| 37 | Shifang | Sichuan | 2008 | 51 | pipled natural gas, CNG | 0.4 | 33,147 | 90,000 | 2 |
| 38 | Kunshan | Jiangsu | 2001 | 50 | pipled natural gas | 0.7 | 73,927 | 451,000 | - |
| 39 | Qidong | Jiangsu | 2007 | 100 | pipled natural gas and/or other gas, bottled LPG | 1.1 | 41,146 | 80,000 | - |
| 40 | Gucheng | Hubei | 2004 | 100 | pipled natural gas | 0.6 | 394 | 13,000 | - |
| 41 | Hangzhou-wan | Zhejiang | 2009 | 100 | pipled natural gas | 5.7 | - | 32,280 | - |
| | Sub-total | | | | | 24.2 | 798,790 | 1,442,030 | 11 |
| | Total | | | | | 155.0 | 7,227,205 | 16,589,463 | 66 |

Source: Company data, Nomura estimates

Financial statements

| Income statement (HK\$mn) | | | | | |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Revenue | 3,367 | 3,747 | 7,006 | 9,993 | 12,488 |
| Cost of goods sold | (2,359) | (2,586) | (4,995) | (6,968) | (8,854) |
| Gross profit | 1,008 | 1,161 | 2,011 | 3,026 | 3,635 |
| SG&A | (588) | (548) | (881) | (1,277) | (1,595) |
| Employee share expense | | | | | |
| Operating profit | 420 | 613 | 1,130 | 1,748 | 2,040 |
| EBITDA | 587 | 776 | 1,354 | 2,035 | 2,406 |
| Depreciation | (140) | (131) | (190) | (252) | (331) |
| Amortisation | (28) | (32) | (34) | (35) | (35) |
| EBIT | 420 | 613 | 1,130 | 1,748 | 2,040 |
| Net interest expense | (14) | (17) | (9) | 27 | 24 |
| Associates & JCEs | 3 | 7 | 9 | 11 | 14 |
| Other income | - | 23 | - | - | - |
| Earnings before tax | 409 | 627 | 1,129 | 1,786 | 2,078 |
| Income tax | (65) | (87) | (224) | (444) | (516) |
| Net profit after tax | 344 | 540 | 905 | 1,342 | 1,562 |
| Minority interests | (47) | (97) | (162) | (240) | (280) |
| Other items | | | | | |
| Preferred dividends | | | | | |
| Normalised NPAT | 297 | 444 | 743 | 1,102 | 1,282 |
| Extraordinary items | | | | | |
| Reported NPAT | 297 | 444 | 743 | 1,102 | 1,282 |
| Dividends | - | (85) | (149) | (220) | (256) |
| Transfer to reserves | 297 | 359 | 595 | 881 | 1,026 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 18.9 | 37.4 | 25.6 | 19.5 | 16.7 |
| FD normalised P/E at price target (x) | 23.8 | 47.2 | 32.3 | 24.6 | 21.1 |
| Reported P/E (x) | 18.8 | 37.4 | 25.6 | 19.5 | 16.7 |
| Dividend yield (%) | - | 0.5 | 0.7 | 1.0 | 1.2 |
| Price/cashflow (x) | 7.6 | 17.6 | 9.3 | 12.7 | 9.7 |
| Price/book (x) | 7.4 | 16.1 | 3.5 | 3.1 | 2.7 |
| EV/EBITDA (x) | 34.3 | 28.0 | 13.7 | 9.0 | 7.5 |
| EV/EBIT (x) | 47.9 | 35.4 | 16.4 | 10.5 | 8.9 |
| Gross margin (%) | 29.9 | 31.0 | 28.7 | 30.3 | 29.1 |
| EBITDA margin (%) | 17.4 | 20.7 | 19.3 | 20.4 | 19.3 |
| EBIT margin (%) | 12.5 | 16.4 | 16.1 | 17.5 | 16.3 |
| Net margin (%) | 8.8 | 11.8 | 10.6 | 11.0 | 10.3 |
| Effective tax rate (%) | 16.0 | 13.9 | 19.8 | 24.8 | 24.8 |
| Dividend payout (%) | - | 19.1 | 20.0 | 20.0 | 20.0 |
| Capex to sales (%) | 19.5 | 16.0 | 15.1 | 13.2 | 13.8 |
| Capex to depreciation (x) | 4.7 | 4.6 | 5.6 | 5.3 | 5.2 |
| ROE (%) | 10.1 | 27.2 | 20.8 | 16.8 | 17.1 |
| ROA (pretax %) | 7.1 | 13.0 | 14.1 | 16.6 | 16.7 |
| Growth (%) | | | | | |
| Revenue | (45.4) | 11.3 | 87.0 | 42.6 | 25.0 |
| EBITDA | (44.1) | 32.1 | 74.5 | 50.3 | 18.2 |
| EBIT | (15.6) | 46.1 | 84.3 | 54.7 | 16.7 |
| Normalised EPS | 333.0 | (49.6) | 46.0 | 31.4 | 16.4 |
| Normalised FDEPS | 338.1 | (49.5) | 46.0 | 31.4 | 16.4 |
| Per share | | | | | |
| Reported EPS (HK\$) | 0.62 | 0.31 | 0.46 | 0.60 | 0.70 |
| Norm EPS (HK\$) | 0.62 | 0.31 | 0.46 | 0.60 | 0.70 |
| Fully diluted norm EPS (HK\$) | 0.62 | 0.31 | 0.46 | 0.60 | 0.70 |
| Book value per share (HK\$) | 1.58 | 0.73 | 3.33 | 3.81 | 4.37 |
| DPS (HK\$) | - | 0.06 | 0.08 | 0.12 | 0.14 |

Source: Nomura estimates

Cashflow (HK\$mn)

| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|--------------------------------------|--------------|----------------|--------------|--------------|--------------|
| EBITDA | 587 | 776 | 1,354 | 2,035 | 2,406 |
| Change in working capital | (355) | 449 | 913 | 96 | 318 |
| Other operating cashflow | 506 | (283) | (227) | (446) | (518) |
| Cashflow from operations | 737 | 942 | 2,041 | 1,685 | 2,205 |
| Capital expenditure | (658) | (599) | (1,058) | (1,323) | (1,720) |
| Free cashflow | 80 | 343 | 982 | 362 | 485 |
| Reduction in investments | (3) | (11) | 1 | 1 | 1 |
| Net acquisitions | (9) | (1,597) | - | - | - |
| Reduction in other LT assets | 127 | (1,380) | (1,990) | 11 | 11 |
| Addition in other LT liabilities | (189) | 1,622 | (0) | - | (0) |
| Adjustments | 29 | (217) | 50 | 117 | 144 |
| Cashflow after investing acts | 35 | (1,240) | (957) | 491 | 640 |
| Cash dividends | (2,731) | (85) | (149) | (220) | (256) |
| Equity issue | - | - | 4,472 | - | - |
| Debt issue | (1,909) | 2,584 | 239 | 981 | 1,127 |
| Convertible debt issue | | | | | |
| Others | 4,175 | (379) | (59) | (89) | (115) |
| Cashflow from financial acts | (466) | 2,120 | 4,504 | 672 | 755 |
| Net cashflow | (431) | 880 | 3,547 | 1,163 | 1,395 |
| Beginning cash | 1,777 | 1,347 | 2,227 | 5,773 | 6,936 |
| Ending cash | 1,347 | 2,227 | 5,773 | 6,936 | 8,331 |
| Ending net debt | (1,199) | 505 | (2,803) | (2,985) | (3,254) |

Source: Nomura estimates

Balance sheet (HK\$mn)

| As at 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|---------------------------------------|--------------|--------------|---------------|---------------|---------------|
| Cash & equivalents | 1,347 | 2,227 | 5,773 | 6,936 | 8,331 |
| Marketable securities | - | - | - | - | - |
| Accounts receivable | 328 | 566 | 1,057 | 1,508 | 1,885 |
| Inventories | 51 | 133 | 256 | 357 | 454 |
| Other current assets | 236 | 279 | 279 | 279 | 279 |
| Total current assets | 1,962 | 3,204 | 7,366 | 9,080 | 10,949 |
| LT investments | 18 | 29 | 29 | 28 | 28 |
| Fixed assets | 1,642 | 2,750 | 3,618 | 4,690 | 6,079 |
| Goodwill | 42 | 352 | 352 | 352 | 352 |
| Other intangible assets | 637 | 632 | 608 | 584 | 560 |
| Other LT assets | 226 | 1,605 | 3,595 | 3,584 | 3,574 |
| Total assets | 4,527 | 8,572 | 15,568 | 18,319 | 21,542 |
| Short-term debt | 108 | 1,040 | 749 | 1,068 | 1,335 |
| Accounts payable | 1,175 | 1,641 | 3,170 | 3,818 | 4,609 |
| Other current liabilities | 449 | 793 | 793 | 793 | 793 |
| Total current liabilities | 1,732 | 3,474 | 4,712 | 5,680 | 6,737 |
| Long-term debt | 39 | 1,692 | 2,221 | 2,882 | 3,742 |
| Convertible debt | | | | | |
| Other LT liabilities | 216 | 1,838 | 1,838 | 1,838 | 1,838 |
| Total liabilities | 1,988 | 7,004 | 8,771 | 10,400 | 12,318 |
| Minority interest | 311 | 536 | 698 | 939 | 1,218 |
| Preferred stock | | | | | |
| Common stock | 141 | 141 | 183 | 183 | 183 |
| Retained earnings | 2,087 | 805 | 5,767 | 6,576 | 7,566 |
| Proposed dividends | - | 85 | 149 | 220 | 256 |
| Other equity and reserves | | | | | |
| Total shareholders' equity | 2,229 | 1,031 | 6,098 | 6,980 | 8,005 |
| Total equity & liabilities | 4,527 | 8,572 | 15,568 | 18,319 | 21,542 |

Liquidity (x)

| | | | | | |
|----------------|------|------|-------|------|------|
| Current ratio | 1.13 | 0.92 | 1.56 | 1.60 | 1.63 |
| Interest cover | 30.7 | 37.0 | 124.8 | na | na |

Leverage

| | | | | | |
|---------------------|----------|------|----------|----------|----------|
| Net debt/EBITDA (x) | net cash | 0.65 | net cash | net cash | net cash |
| Net debt/equity (%) | net cash | 48.9 | net cash | net cash | net cash |

Activity (days)

| | | | | | |
|-----------------|--------|---------|---------|---------|---------|
| Days receivable | 86.5 | 43.5 | 42.3 | 46.9 | 49.7 |
| Days inventory | 72.8 | 13.0 | 14.2 | 16.1 | 16.8 |
| Days payable | 253.8 | 198.8 | 175.8 | 183.0 | 174.2 |
| Cash cycle | (94.5) | (142.2) | (119.3) | (120.1) | (107.7) |

Source: Nomura estimates

Net cash due to the share placement in Sep 2010

Action

BJE's quality asset portfolio combines two hot areas in our Chinese utilities universe, namely gas and water. We see BJE, along with CR Gas, playing a major role in industry consolidation in the long run. We reiterate our BUY rating with revised PT of HK\$70.50, which implies 35.4% potential upside.

Catalysts

Acquisition of new piped gas projects outside Beijing, investment in Shaanxi-Beijing #4 and water project announcements are potential growth catalysts.

Anchor themes

We are upbeat on China's gas distribution sector, considering: 1) favourable government policies; 2) robust demand growth underpinned by the transition to clean and low-cost energy; 3) stable margins attributable to strong cost pass-through capability; and 4) potential upside from new energy initiatives.

Quality assets, undemanding valuation

① Stable-growth engine: gas and brewery

We expect the piped gas business to record a sales volume CAGR over FY09-16F of 14.9-17.9% to 15-18bcm. Besides the long-distance pipeline project, we believe that Shaanxi-Beijing #4 and any potential projects outside Beijing (which we have not included in our model) could present upside potential to our current estimates. Brewery business, while less-than-exciting, should continue to enjoy stable growth (5-10% organic growth, mainly outside Beijing).

② High-growth engine: water

We believe BJE will consolidate its water business into a single vehicle by injecting its four water assets into BEW by early FY11F. Thereafter, we expect BEW to grow its capacity at 2mn m3 pa, as government policies continue to bode well for waste water treatment companies, in our view.

③ Potential leader of gas industry consolidation

BJE plans to expand outside Beijing for more new gas projects. We see BJE, along with CR Gas, leading gas industry consolidation in the long run, given its SOE status, and strong cashflow and balance sheet.

④ Undemanding valuation; reiterate BUY

At the current level, BJE shares are trading at FY11F P/E of 17.5x, compared with a peer average of 19.6x. The current valuation looks undemanding considering the company's quality asset portfolio. We reiterate our BUY rating with a revised price target of HK\$70.50, which implies 35.4% potential upside.

| | |
|---------------------------|------------------------------------|
| Closing price on 2 Nov | HK\$52.1 |
| Price target | HK\$70.5 (from HK\$60.9) |
| Upside/downside | 35.4% |
| Difference from consensus | 13.9% |
| FY11F net profit (HK\$m) | 3,538 |
| Difference from consensus | 4.6% |
| Source: Nomura | |

Nomura vs consensus

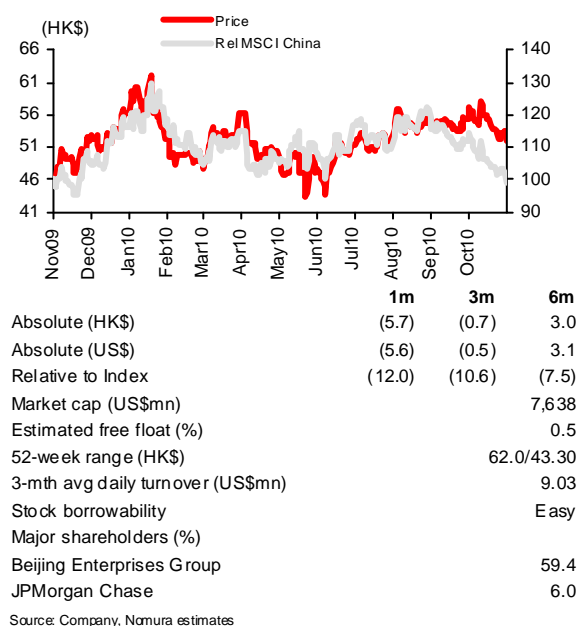
Our earnings estimates are in line with consensus, which assumes strong CAGRs for gas sales volumes and water business.

Key financials & valuations

| 31 Dec (HK\$m) | FY09 | FY10F | FY11F | FY12F |
|---------------------------|--------|--------|--------|--------|
| Revenue | 24,208 | 26,862 | 33,021 | 38,078 |
| Reported net profit | 2,399 | 3,031 | 3,538 | 4,294 |
| Normalised net profit | 2,399 | 3,031 | 3,538 | 4,294 |
| Normalised EPS (HK\$) | 2.11 | 2.67 | 3.11 | 3.78 |
| Norm. EPS growth (%) | 5.2 | 26.3 | 16.8 | 21.3 |
| Norm. P/E (x) | 25.3 | 20.4 | 17.5 | 14.4 |
| EV/EBITDA (x) | 11.4 | 10.0 | 8.6 | 7.5 |
| Price/book (x) | 1.9 | 1.8 | 1.6 | 1.5 |
| Dividend yield (%) | 1.2 | 1.6 | 1.8 | 2.1 |
| ROE (%) | 7.9 | 9.3 | 9.9 | 10.8 |
| Net debt/equity (%) | 4.9 | 8.4 | 3.5 | 3.2 |
| Earnings revisions | | | | |
| Previous norm. net profit | | 3,022 | 3,466 | na |
| Change from previous (%) | | 0.3 | 2.1 | na |
| Previous norm. EPS (HK\$) | | 2.66 | 3.05 | na |

Source: Company, Nomura estimates

Share price relative to MSCI China



Investment highlights

Growth engines: gas and water

We like Beijing Enterprises Holdings' (BJE) sustainable growth story and are positive on most of the company's business segments. We believe future growth momentum will mainly rely on the gas and water business. Our estimates show gas remaining as the major earnings contributor, with growth coming from the expansion of suburban areas in Beijing, plus the commissioning of long-distance pipelines. Water also looks set to record strong growth and we think it will overtake the brewery business in FY11F as the 2nd leading earnings contributor. Longer term, we expect BJE to play a major role in gas industry consolidation. Considering BJE's quality assets, we believe the current valuation at FY11F P/E of 17.5x is undemanding. We reiterate BUY with a revised price target of HK\$70.5.

Gas and water likely to drive growth momentum

Gas: leverage on existing business; a likely leader in industry consolidation in long term

Piped gas business (Beijing)

Despite the high gas penetration rate in Beijing of roughly 80% (current), we believe there is substantial room for expansion for BJE in the satellite cities in the Greater Beijing area. BJE has revised its guidance, raising its gas sales volume target to 15-18bcm by FY16F (from 12bcm previously), implying an FY09-16F gas sales volume CAGR of 14.9-17.9%. For BJE, gas supply is unlikely to be a problem given that its main gas source, the Changqing gas field (via the Shaanxi-Beijing Gas Pipeline), has sufficient supply to cover BJE's gas sales volumes.

Gas to remain the major earnings contributor, with growth from expansion outside Beijing and commissioning of long-distance pipelines

Piped gas business: looking outside Beijing

In the near term, Beijing remains BJE's key development area. Longer term, however, the company plans to look outside Beijing for gas projects. Currently, the company has only around four projects outside Beijing, including JVs in Jinzhou and Shandong.

Long-distance pipeline project: potential upside from other projects

We expect the long-distance pipeline will see a significant increase in gas transmission volumes over the next couple of years. The construction of Shaanxi-Beijing #3 should be completed by November 2010, with ramp-up volumes of 5bcm each in 1Q11, end-2011 and mid-2012. In addition, Shaanxi-Beijing #4 is under review, with total planned capacity of 10-12bcm. We have not factored Shaanxi-Beijing #4 in our current assumptions, thus conclusion of the project will likely provide upside to our estimates.

Potential leader of gas industry consolidation in long term

We also believe that BJE will be a potential leader of consolidation in the gas industry in the long run. With its plans to go outside Beijing to secure gas projects, leveraging on its SOE status and strong balance sheet, we believe that BJE can secure some medium- to large-size projects. This should see BJE expand and lead sector consolidation further out alongside CR Gas.

Water: aggressive plans for further growth

For the water asset portfolio, BJE owns the Beijing No. 9 and 10 water treatment concession, and 43.73% of Beijing Enterprises Water (BEW). Near term, we believe BJE will consolidate the water assets into a single vehicle by injecting the remaining four water assets in BEW. Following the conversion of convertible bonds in August 2010, BJE's BEW stake fell to 43.73%, short of the majority stake needed to consolidate BEW into BJE's books. In this context, both companies appear eager to complete the pending injection as soon as possible, with BEW likely to issue shares to BJE to purchase the assets. We expect the transaction to take place by early 2011F and valuation to be reasonable at 1-1.3x book value.

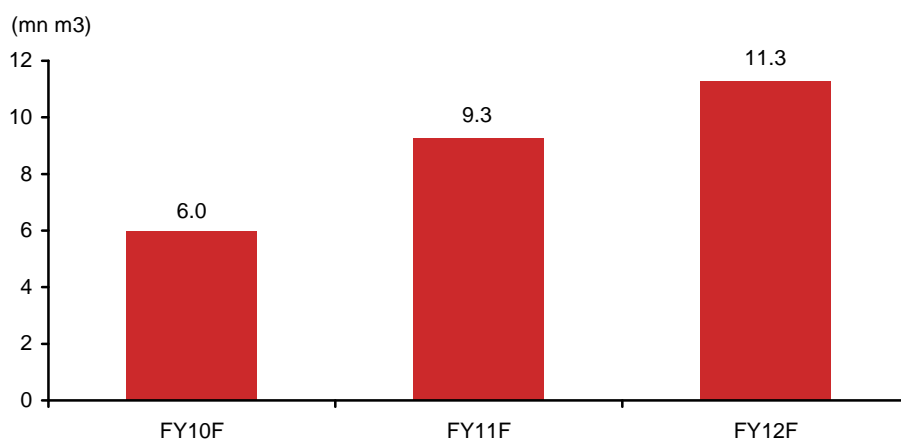
Both BJE and its water arm BEW appear eager to complete the pending injection

Exhibit 54. BJE: potential water asset injection into BEW

| Plant | Type | Location | Capacity (m3)/ day |
|--------------------|----------------------|----------|--------------------|
| No. 9 water plant | Tap water supply | Beijing | 500,000 |
| No. 10 water plant | Tap water supply | Beijing | 500,000 |
| Haikou plants | Wastewater treatment | Hainan | 250,000 |
| Weifang plants | Wastewater treatment | Shandong | 30,000 |
| Total | | | 1,280,000 |

Source: Company data, Nomura research

Project announcements for BEW are likely to act as positive catalysts for BJE. As at June 2010, BEW had added 1.08mn m3 of daily capacity in the year to date, bringing its total capacity to 4.6mn m3. BEW looks on track to achieve its FY10F daily capacity target of 6mn m3 (excluding the potential asset injection from BJE). BEW's management guided for continued capacity growth of 2mn m3 pa thereafter, underpinned by favourable government policy for wastewater treatment companies. We expect the earnings contribution from water business to overtake the earnings contribution from brewery business in FY11F.

Exhibit 55. BEW: daily water treatment capacity projections

Source: Nomura estimates

Brewery: less than exciting, but offers stable growth

We expect the brewery business to maintain its stable operation, with organic growth of 5-10% pa. Gross margin looks sustainable, given the company's ability to pass through the rising raw materials costs to customers. BJE targets sales volume of 5mn thousand litres for FY10F and 8mn thousand litres by FY15F, implying a CAGR of 10%. With a market share of about 80% in Beijing, BJE will likely see most of its future growth come from areas outside Beijing, such as Hunan, Jiangxi, Guangdong and Fujian.

Investment concerns

Wellhead price hike: delayed pass-through

With the wellhead price hike of RMB0.23/m³ effective from 1 June, 2010, BJE received government approval for a gas tariff hike of RMB0.33/m³ for C&I customers (>85% of total gas sales volumes), which it implemented on 28 September, 2010. For residential users (ie, the remaining <15% of total gas sales volumes), BJE has already submitted a proposal to the local pricing bureau and expects a public hearing soon.

Exhibit 56. Beijing: gas price tariff hikes by sector

| Category | Before (RMB/m ³) | After (RMB/m ³) | Difference (RMB/m ³) | Change (%) |
|---------------------------|---------------------------------|--------------------------------|-------------------------------------|---------------|
| Industrial | 2.35 | 2.84 | 0.49 | 20.9 |
| Public sector | 2.55 | 2.84 | 0.29 | 11.4 |
| Heating | 1.95 | 2.28 | 0.33 | 16.9 |
| Cooling | 1.95 | 2.28 | 0.33 | 16.9 |
| Cogeneration power plants | 1.85 | 2.28 | 0.43 | 23.2 |
| CNG | 1.90 | 2.23 | 0.33 | 17.4 |

Source: Company data, Nomura research

Given the time lag of cost pass-through, BJE may experience a three-month margin squeeze. BJE plans to negotiate to apply the tariff hike retrospectively, or to discuss with PetroChina to apply the wellhead price hike at the same as or closer to the downstream price hike. While the company is still in discussions regarding the above, with its SOE status, we remain positive that BJE can recover at least a portion of the lost margins from the delay in cost pass-through.

Decline in toll business, but chance to swap assets

A change in Capital Airport Expressway's toll policy resulted in a toll business profit decline in 1H10 for BJE. Despite management's intention to dispose of this expressway, it can only dispose of the asset to parties related to the Beijing government given the importance of the expressway to Beijing. Alternatively, BJE is seeking the chance to swap the expressway with other parent assets. Overall, the proposal is still at the discussion stage and BJE is in no rush to dispose of the expressway. Any asset swap is likely to be a catalyst for BJE, in our view.

BJE is in no rush to dispose of its toll road business, as it wants a chance to swap assets with its parent

Investment in risky solar business

The company is looking at the possibility of investing in emerging industries, including solid waste treatment and the more risky solar photovoltaic power. We are cautious on solar business, given the unattractive cost structure and immature technology involved. BJE also seems to have noticed the dim prospects of the solar business, slowing its move into the segment after having made an initial investment of RMB30-40mn. The company is now reviewing the costs and technology before committing any additional capital to the business.

Impact of interest rate hike

As at end-FY09, RMB-denominated loans represented about 64% of the company's total borrowings. With the recent interest rate hike of 0.25pp and our house forecast for a 1pp rate hike in 2011F, we have factored into our model a rising interest rate trend, assuming the company's effective interest rate will rise from 3.7% in FY09 to 4% in FY10F and 4.7% in FY11F. Based on our sensitivity analysis, we estimate that each 1pp increase in the interest rate would cut FY11F earnings by just 2.7%.

Valuation

Undemanding valuation; reiterate BUY

At the current level, BJE shares are trading at FY11F P/E of 17.5x, versus a peer average of 19.6x. The shares look undemanding, in our view, considering the company's quality assets and underlying growth potential. We reiterate our BUY rating and revise up our PT to HK\$70.5 (from HK\$60.9), implying upside of 35.4%.

PT revised up to HK\$70.5

Our PT of HK\$70.5 is based on a sum-of-the-parts (SOTP) valuation, which takes into account the different business nature and risk profile of BJE's investments. We divided BJE into five parts:

Piped gas operation. We value the piped gas operation business using a DCF model, which assumes 0% terminal growth and a WACC of 7.6%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects with unspecified commencement dates. In addition, we have not factored in any future wellhead price hikes, nor any downstream tariff hikes in our assumptions, as we believe that any wellhead price hike can be fully passed through to the end users and a fixed-dollar margin can be maintained.

Brewery. We value the brewery business using the current market value of 56.48%-owned Yanjing Beer, which is listed on the Shanghai Stock Exchange.

Water treatment. We value BEW using our price target for the stock. For Beijing No. 9 and the 10 Water Treatment Plant concession, we value the assets using a DCF model, assuming 0% terminal growth and a WACC of 7.6%.

Expressway & toll road. We value the toll road business using a DCF model, assuming 0% terminal growth and a WACC of 7.6%

Other. We value the other businesses using EV/EBITDA and market value approaches. For the stakes in Beijing Development and Biosino Bio-Tech, we value the investments using the current market value of the companies. We value the remaining assets the EV/EBITDA multiple of the HSCEI.

Exhibit 57. BJ Enterprises: sum-of-the-parts valuation

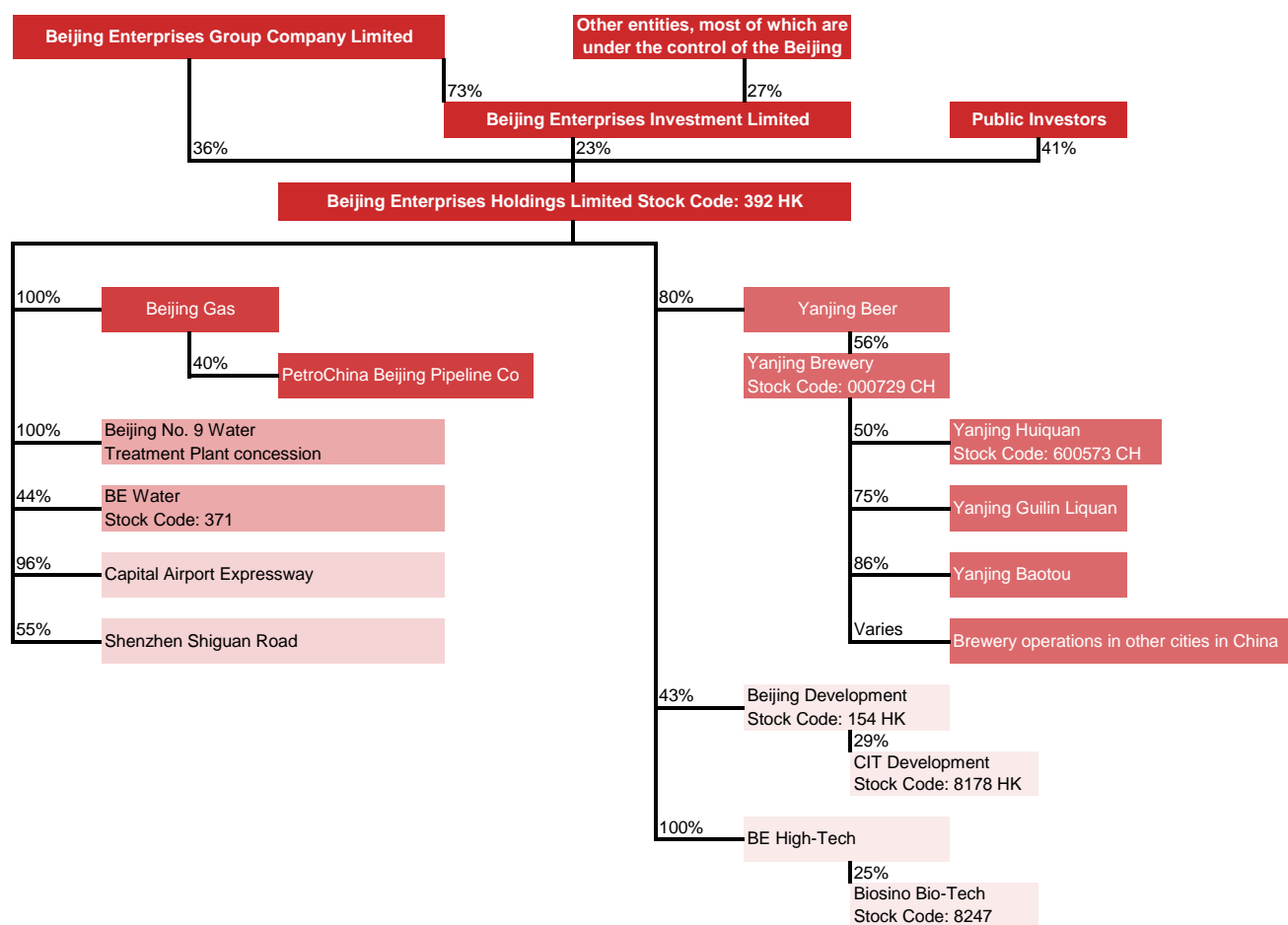
| FY Dec (HK\$m) | Valuation | | Discount rate | HK\$ |
|------------------------|--------------------------|---|---------------|--------------|
| Piped gas operation | DCF | @ | 7.6% | 54.78 |
| Brewery | Market value | | | 11.12 |
| Water treatment | Target price & DCF | @ | 7.6% | 11.26 |
| Expressway & toll road | DCF | @ | 7.6% | 1.44 |
| Corporate & others | EV/EBITDA & Market value | @ | 3.2x | 0.55 |
| Corporate value | | | | 79.16 |
| Net cash/(debt) | | | | (1.17) |
| Minority interest | | | | (7.45) |
| Equity value | | | | 70.53 |

Source: Nomura research

Investment risks

Risks to our positive view include: 1) slower-than-expected sales growth for the gas, water and brewery businesses; 2) unfavourable regulatory changes to the above three segments; and 3) value-destructive asset acquisitions.

Exhibit 58. BJ Enterprises: shareholding structure



Source: Company data, Nomura research

Financial statements

| Income statement (HK\$mn) | | | | | |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Revenue | 19,704 | 24,208 | 26,862 | 33,021 | 38,078 |
| Cost of goods sold | (15,199) | (18,390) | (20,611) | (25,837) | (29,829) |
| Gross profit | 4,505 | 5,819 | 6,251 | 7,184 | 8,249 |
| SG&A | (1,924) | (3,024) | (3,267) | (3,798) | (4,272) |
| Employee share expense | | | | | |
| Operating profit | 2,580 | 2,795 | 2,984 | 3,386 | 3,977 |
| EBITDA | 3,929 | 4,239 | 4,494 | 4,984 | 5,648 |
| Depreciation | (1,208) | (1,306) | (1,383) | (1,477) | (1,556) |
| Amortisation | (140) | (138) | (127) | (121) | (115) |
| EBIT | 2,580 | 2,795 | 2,984 | 3,386 | 3,977 |
| Net interest expense | (291) | (274) | (370) | (540) | (572) |
| Associates & JCEs | 766 | 1,084 | 1,686 | 2,069 | 2,460 |
| Other income | | | | | |
| Earnings before tax | 3,055 | 3,605 | 4,300 | 4,915 | 5,865 |
| Income tax | (359) | (559) | (720) | (807) | (956) |
| Net profit after tax | 2,696 | 3,046 | 3,580 | 4,107 | 4,909 |
| Minority interests | (414) | (648) | (550) | (569) | (615) |
| Other items | | | | | |
| Preferred dividends | | | | | |
| Normalised NPAT | 2,282 | 2,399 | 3,031 | 3,538 | 4,294 |
| Extraordinary items | | | | | |
| Reported NPAT | 2,282 | 2,399 | 3,031 | 3,538 | 4,294 |
| Dividends | (739) | (739) | (934) | (1,091) | (1,323) |
| Transfer to reserves | 1,543 | 1,659 | 2,097 | 2,448 | 2,970 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 25.9 | 25.3 | 20.4 | 17.5 | 14.4 |
| FD normalised P/E at price target (x) | 35.1 | 34.3 | 27.6 | 23.7 | 19.5 |
| Reported P/E (x) | 26.0 | 24.7 | 19.5 | 16.7 | 13.8 |
| Dividend yield (%) | 1.2 | 1.2 | 1.6 | 1.8 | 2.1 |
| Price/cashflow (x) | 29.7 | 19.1 | 17.1 | 17.2 | 14.4 |
| Price/book (x) | 2.0 | 1.9 | 1.8 | 1.6 | 1.5 |
| EV/EBITDA (x) | 12.8 | 11.4 | 10.0 | 8.6 | 7.5 |
| EV/EBIT (x) | 18.0 | 15.7 | 13.3 | 11.1 | 9.4 |
| Gross margin (%) | 22.9 | 24.0 | 23.3 | 21.8 | 21.7 |
| EBITDA margin (%) | 19.9 | 17.5 | 16.7 | 15.1 | 14.8 |
| EBIT margin (%) | 13.1 | 11.5 | 11.1 | 10.3 | 10.4 |
| Net margin (%) | 11.6 | 9.9 | 11.3 | 10.7 | 11.3 |
| Effective tax rate (%) | 11.8 | 15.5 | 16.7 | 16.4 | 16.3 |
| Dividend payout (%) | 32.4 | 30.8 | 30.8 | 30.8 | 30.8 |
| Capex to sales (%) | 13.1 | 9.3 | 10.0 | 7.7 | 6.9 |
| Capex to depreciation (x) | 2.1 | 1.7 | 1.9 | 1.7 | 1.7 |
| ROE (%) | 8.1 | 7.9 | 9.3 | 9.9 | 10.8 |
| ROA (pretax %) | 8.2 | 8.2 | 9.0 | 9.8 | 10.8 |
| Growth (%) | | | | | |
| Revenue | 79.5 | 22.9 | 11.0 | 22.9 | 15.3 |
| EBITDA | 47.9 | 7.9 | 6.0 | 10.9 | 13.3 |
| EBIT | 49.0 | 8.3 | 6.8 | 13.5 | 17.5 |
| Normalised EPS | 23.3 | 5.2 | 26.3 | 16.8 | 21.3 |
| Normalised FDEPS | 23.7 | 2.5 | 24.1 | 16.8 | 21.3 |
| Per share | | | | | |
| Reported EPS (HK\$) | 2.01 | 2.11 | 2.67 | 3.11 | 3.78 |
| Norm EPS (HK\$) | 2.01 | 2.11 | 2.67 | 3.11 | 3.78 |
| Fully diluted norm EPS (HK\$) | 2.01 | 2.06 | 2.55 | 2.98 | 3.62 |
| Book value per share (HK\$) | 26.06 | 27.52 | 29.48 | 32.22 | 34.86 |
| DPS (HK\$) | 0.65 | 0.65 | 0.82 | 0.92 | 1.11 |

Source: Nomura estimates

Growth in associates & JCEs are mainly attributable to the strong growth in water business and the commencement of Shaanxi-Beijing #3

Cashflow (HK\$mn)

| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|--------------------------------------|----------------|----------------|--------------|--------------|--------------|
| EBITDA | 3,929 | 4,239 | 4,494 | 4,984 | 5,648 |
| Change in working capital | 517 | 638 | (311) | (730) | (573) |
| Other operating cashflow | (2,455) | (1,784) | (720) | (808) | (957) |
| Cashflow from operations | 1,992 | 3,093 | 3,462 | 3,447 | 4,118 |
| Capital expenditure | (2,575) | (2,257) | (2,689) | (2,557) | (2,634) |
| Free cashflow | (583) | 836 | 774 | 890 | 1,484 |
| Reduction in investments | 136 | (6) | - | - | - |
| Net acquisitions | | | | | |
| Reduction in other LT assets | (1,235) | (3,124) | (2,392) | (1,948) | (2,021) |
| Addition in other LT liabilities | 446 | 222 | - | - | - |
| Adjustments | (306) | 937 | 1,812 | 2,211 | 2,625 |
| Cashflow after investing acts | (1,543) | (1,134) | 194 | 1,153 | 2,088 |
| Cash dividends | (856) | (942) | (972) | (1,161) | (1,355) |
| Equity issue | - | - | - | - | - |
| Debt issue | (54) | 971 | 2,423 | 2,416 | 2,305 |
| Convertible debt issue | 100 | 2,370 | 37 | 38 | 8 |
| Others | 948 | 1,555 | (497) | (682) | (737) |
| Cashflow from financial acts | 137 | 3,954 | 992 | 611 | 221 |
| Net cashflow | (1,406) | 2,819 | 1,186 | 1,764 | 2,309 |
| Beginning cash | 8,072 | 6,667 | 9,486 | 10,672 | 12,436 |
| Ending cash | 6,667 | 9,486 | 10,672 | 12,436 | 14,745 |
| Ending net debt | 917 | 1,538 | 2,812 | 1,327 | 1,331 |

Source: Nomura estimates

Balance sheet (HK\$mn)

| As at 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & equivalents | 6,667 | 9,486 | 10,672 | 12,436 | 14,745 |
| Marketable securities | | | | | |
| Accounts receivable | 1,056 | 1,098 | 1,218 | 1,497 | 1,727 |
| Inventories | 3,067 | 2,995 | 3,357 | 4,208 | 4,858 |
| Other current assets | 2,166 | 2,598 | 2,598 | 2,597 | 2,596 |
| Total current assets | 12,956 | 16,177 | 17,845 | 20,738 | 23,926 |
| LT investments | 199 | 204 | 204 | 204 | 204 |
| Fixed assets | 19,125 | 20,175 | 21,453 | 22,505 | 23,556 |
| Goodwill | 8,538 | 8,649 | 8,649 | 8,649 | 8,649 |
| Other intangible assets | 1,828 | 1,724 | 1,626 | 1,533 | 1,446 |
| Other LT assets | 9,051 | 12,175 | 14,567 | 16,516 | 18,537 |
| Total assets | 51,697 | 59,105 | 64,344 | 70,145 | 76,318 |
| Short-term debt | 3,173 | 3,038 | 3,848 | 4,730 | 5,455 |
| Accounts payable | 1,190 | 1,408 | 1,578 | 1,978 | 2,284 |
| Other current liabilities | 5,617 | 6,439 | 6,439 | 6,439 | 6,439 |
| Total current liabilities | 9,979 | 10,885 | 11,865 | 13,148 | 14,178 |
| Long-term debt | 3,895 | 5,264 | 6,877 | 8,412 | 9,992 |
| Convertible debt | 516 | 2,721 | 2,759 | 621 | 630 |
| Other LT liabilities | 996 | 1,218 | 1,218 | 1,218 | 1,218 |
| Total liabilities | 15,386 | 20,088 | 22,719 | 23,398 | 26,017 |
| Minority interest | 6,679 | 7,712 | 8,089 | 8,480 | 8,903 |
| Preferred stock | | | | | |
| Common stock | 114 | 114 | 114 | 119 | 119 |
| Retained earnings | 29,007 | 30,680 | 32,776 | 37,394 | 40,364 |
| Proposed dividends | 512 | 512 | 647 | 755 | 916 |
| Other equity and reserves | | | | | |
| Total shareholders' equity | 29,632 | 31,305 | 33,536 | 38,268 | 41,399 |
| Total equity & liabilities | 51,697 | 59,105 | 64,344 | 70,145 | 76,318 |

Liquidity (x)

| | | | | | |
|----------------|------|------|------|------|------|
| Current ratio | 1.30 | 1.49 | 1.50 | 1.58 | 1.69 |
| Interest cover | 8.9 | 10.2 | 8.1 | 6.3 | 7.0 |

Leverage

| | | | | | |
|---------------------|------|------|------|------|------|
| Net debt/EBITDA (x) | 0.23 | 0.36 | 0.63 | 0.27 | 0.24 |
| Net debt/equity (%) | 3.1 | 4.9 | 8.4 | 3.5 | 3.2 |

Activity (days)

| | | | | | |
|-----------------|------|------|------|------|------|
| Days receivable | 17.4 | 16.2 | 15.7 | 15.0 | 15.5 |
| Days inventory | 65.1 | 60.2 | 56.2 | 53.4 | 55.6 |
| Days payable | 35.3 | 25.8 | 26.4 | 25.1 | 26.1 |
| Cash cycle | 47.3 | 50.6 | 45.5 | 43.3 | 45.0 |

Source: Nomura estimates

Action

Supported by PetroChina's rich gas resources, Kunlun Energy looks well positioned to capture China's robust natural gas demand growth. We forecast an earnings CAGR of 50% over FY09-12F, driven by strong natural gas volumes and supported by E&P. We maintain a BUY rating and price target of HK\$13.5. At 15.7x FY11F P/E, and at a discount to its natural gas peers at 19.6x, valuation appears attractive.

Catalysts

Potential catalysts include: 1) natural gas price reform; 2) potential asset injections; 3) favourable government policies on natural gas usage; 4) higher crude oil price.

Anchor themes

We expect China's natural gas demand to triple over the next decade to 300bcm, based on the government's policy favouring clean energy. We expect natural gas price reform and hence a gradual price hike to reflect import/international prices.

| | |
|---------------------------|--|
| Closing price on 2 Nov | HK\$10.08 |
| Price target | HK\$13.50 (set on 13 Oct 10) |
| Upside/downside | 33.9% |
| Difference from consensus | 23.0% |
| FY11F net profit (HK\$m) | 3,182 |
| Difference from consensus | 4.6% |
| Source: Nomura | |

Nomura vs consensus

Our FY11F earnings estimates are nearly in-line with consensus.

Running on two legs

① A hybrid (E&P and natural gas) business model

We think Kunlun's near-term earnings (70% of EBIT) are driven by its original E&P business, which is geared to oil prices. Its new business of natural gas distribution (mainly CNG) is able to pass on price increases although the government has prevented full pass-through of prices for town gas businesses in the recent price hike.

② Positive catalysts: robust natural gas demand and potential natural gas price hikes

The Chinese government is promoting clean energy development to raise the proportion of natural gas consumption in energy consumption from 4% to 8% by 2015. With limited domestic natural gas supply, it will be importing natural gas from Turkmenistan and Australia. Further natural gas price hikes are imminent to narrow the disparity between domestic and import natural gas prices, in our view. We think robust natural gas demand and potential natural gas price hikes could be positive catalysts for the company's earnings.

③ Potential asset injections

We expect to see potential asset injections into Kunlun Energy to lift its natural gas earnings contribution. There is a likelihood that Kunlun Gas (its unlisted sister company), as well as some other natural gas related businesses (eg, LNG terminals), will be injected over the next few years when its IRR reaches 12% or above.

④ Attractive valuation; maintain BUY; risks

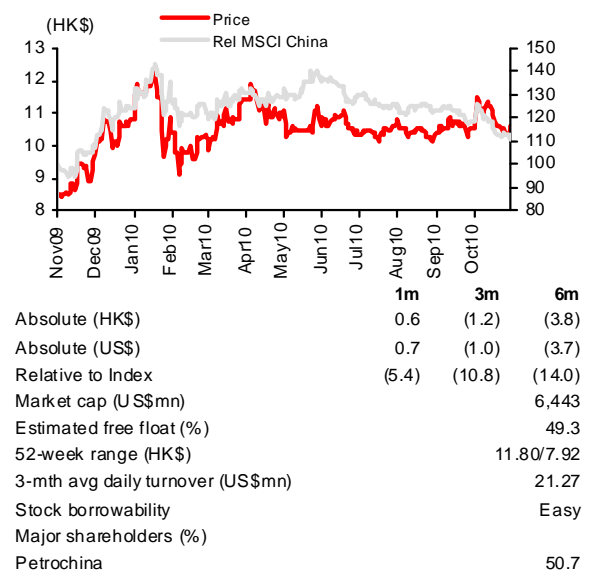
We value Kunlun Energy at HK\$13.5, based on an FY11F ROACE of 17.7% and WACC of 7.1% with a LT growth rate of 3%. Our price target implies upside of 33.9%. **Investment risks** include policy risks, uncertainty of Kunlun Gas injection and timing and profitability of natural gas earnings contribution, crude oil prices and production risks, as well as share issuance.

Key financials & valuations

| 31 Dec (HK\$m) | FY09 | FY10F | FY11F | FY12F |
|---------------------------|--------|----------|----------|----------|
| Revenue | 5,280 | 7,380 | 8,920 | 19,352 |
| Reported net profit | 1,204 | 2,560 | 3,182 | 4,038 |
| Normalised net profit | 1,204 | 2,560 | 3,182 | 4,038 |
| Normalised EPS (HK\$) | 0.27 | 0.52 | 0.64 | 0.82 |
| Norm. EPS growth (%) | (62.3) | 92.9 | 24.3 | 26.9 |
| Norm. P/E (x) | 38.2 | 19.5 | 15.7 | 12.4 |
| EV/EBITDA (x) | 18.3 | 9.0 | 7.6 | 5.8 |
| Price/book (x) | 3.5 | 3.0 | 2.6 | 2.3 |
| Dividend yield (%) | 0.7 | 1.5 | 1.8 | 2.3 |
| ROE (%) | 9.6 | 16.7 | 18.0 | 19.8 |
| Net debt/equity (%) | | net cash | net cash | net cash |
| Earnings revisions | | | | |
| Previous norm. net profit | | 2,560 | 3,182 | 4,038 |
| Change from previous (%) | | - | - | - |
| Previous norm. EPS (HK\$) | | 0.52 | 0.64 | 0.82 |

Source: Company, Nomura estimates

Share price relative to MSCI China



Source: Company, Nomura estimates

Financial statements

| Income statement (HK\$mn) | | | | | |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Revenue | 6,788 | 5,280 | 7,380 | 8,920 | 19,352 |
| Cost of goods sold | (3,622) | (3,427) | (4,273) | (5,293) | (12,171) |
| Gross profit | 3,166 | 1,853 | 3,107 | 3,627 | 7,181 |
| SG&A | (801) | (489) | (687) | (935) | (3,033) |
| Employee share expense | | | | | |
| Operating profit | 2,365 | 1,365 | 2,420 | 2,692 | 4,148 |
| EBITDA | 3,162 | 1,921 | 3,094 | 3,481 | 5,404 |
| Depreciation | (797) | (556) | (674) | (789) | (1,256) |
| Amortisation | | | | | |
| EBIT | 2,365 | 1,365 | 2,420 | 2,692 | 4,148 |
| Net interest expense | (50) | (96) | (93) | (130) | (143) |
| Associates & JCEs | 3,398 | 507 | 2,039 | 2,834 | 3,107 |
| Other income | 62 | 79 | (30) | - | - |
| Earnings before tax | 5,774 | 1,855 | 4,336 | 5,397 | 7,112 |
| Income tax | (1,094) | (391) | (997) | (1,241) | (1,636) |
| Net profit after tax | 4,681 | 1,463 | 3,338 | 4,155 | 5,476 |
| Minority interests | (1,295) | (260) | (778) | (973) | (1,438) |
| Other items | | | | | |
| Preferred dividends | | | | | |
| Normalised NPAT | 3,385 | 1,204 | 2,560 | 3,182 | 4,038 |
| Extraordinary items | | | | | |
| Reported NPAT | 3,385 | 1,204 | 2,560 | 3,182 | 4,038 |
| Dividends | (666) | (346) | (735) | (913) | (1,159) |
| Transfer to reserves | 2,719 | 858 | 1,825 | 2,269 | 2,879 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 14.3 | 38.2 | 19.5 | 15.7 | 12.4 |
| FD normalised P/E at price target (x) | 19.2 | 51.1 | 26.1 | 21.0 | 16.6 |
| Reported P/E (x) | 14.2 | 37.6 | 19.5 | 15.7 | 12.4 |
| Dividend yield (%) | 1.5 | 0.7 | 1.5 | 1.8 | 2.3 |
| Price/cashflow (x) | 19.1 | 29.3 | 24.2 | 22.4 | 14.8 |
| Price/book (x) | 4.1 | 3.5 | 3.0 | 2.6 | 2.3 |
| EV/EBITDA (x) | 7.2 | 18.3 | 9.0 | 7.6 | 5.8 |
| EV/EBIT (x) | 8.2 | 23.8 | 10.3 | 8.7 | 6.8 |
| Gross margin (%) | 46.6 | 35.1 | 42.1 | 40.7 | 37.1 |
| EBITDA margin (%) | 46.6 | 36.4 | 41.9 | 39.0 | 27.9 |
| EBIT margin (%) | 34.8 | 25.8 | 32.8 | 30.2 | 21.4 |
| Net margin (%) | 49.9 | 22.8 | 34.7 | 35.7 | 20.9 |
| Effective tax rate (%) | 18.9 | 21.1 | 23.0 | 23.0 | 23.0 |
| Dividend payout (%) | 19.7 | 28.7 | 28.7 | 28.7 | 28.7 |
| Capex to sales (%) | 18.1 | 29.4 | 14.3 | 12.2 | 5.6 |
| Capex to depreciation (x) | 1.5 | 2.8 | 1.6 | 1.4 | 0.9 |
| ROE (%) | 34.1 | 9.6 | 16.7 | 18.0 | 19.8 |
| ROA (pretax %) | 57.5 | 14.4 | 27.4 | 25.9 | 26.9 |
| Growth (%) | | | | | |
| Revenue | 76.6 | (22.2) | 39.8 | 20.9 | 117.0 |
| EBITDA | 73.1 | (39.3) | 61.1 | 12.5 | 55.3 |
| EBIT | 101.5 | (42.3) | 77.4 | 11.2 | 54.1 |
| Normalised EPS | 75.4 | (62.3) | 92.9 | 24.3 | 26.9 |
| Normalised FDEPS | 75.8 | (62.5) | 95.8 | 24.3 | 26.9 |
| Per share | | | | | |
| Reported EPS (HK\$) | 0.71 | 0.27 | 0.52 | 0.64 | 0.82 |
| Norm EPS (HK\$) | 0.71 | 0.27 | 0.52 | 0.64 | 0.82 |
| Fully diluted norm EPS (HK\$) | 0.70 | 0.26 | 0.52 | 0.64 | 0.82 |
| Book value per share (HK\$) | 2.44 | 2.87 | 3.32 | 3.81 | 4.44 |
| DPS (HK\$) | 0.15 | 0.07 | 0.15 | 0.18 | 0.23 |

Revenue growth in FY12F is mainly driven by the Jiangsu and Dalian LNG terminals coming on-stream

Source: Nomura estimates

Cashflow (HK\$mn)

| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|--------------------------------------|----------------|--------------|----------------|----------------|----------------|
| EBITDA | 3,162 | 1,921 | 3,094 | 3,481 | 5,404 |
| Change in working capital | 69 | 854 | (37) | (12) | (392) |
| Other operating cashflow | (715) | (1,231) | (997) | (1,241) | (1,636) |
| Cashflow from operations | 2,517 | 1,544 | 2,059 | 2,227 | 3,376 |
| Capital expenditure | (1,232) | (1,554) | (1,057) | (1,086) | (1,090) |
| Free cashflow | 1,285 | (10) | 1,002 | 1,141 | 2,286 |
| Reduction in investments | (2,354) | 90 | | | |
| Net acquisitions | (70) | (1,482) | (3,192) | (4,000) | (4,000) |
| Reduction in other LT assets | (69) | (633) | | | |
| Addition in other LT liabilities | 308 | 119 | - | - | - |
| Adjustments | 4,269 | 1,421 | 1,176 | 1,608 | 1,739 |
| Cashflow after investing acts | 3,369 | (496) | (1,013) | (1,251) | 25 |
| Cash dividends | (581) | (669) | (346) | (735) | (913) |
| Equity issue | (1,112) | 3,694 | - | - | - |
| Debt issue | 273 | (314) | 779 | - | - |
| Convertible debt issue | | | | | |
| Others | (965) | (36) | (136) | (161) | (161) |
| Cashflow from financial acts | (2,385) | 2,676 | 297 | (896) | (1,075) |
| Net cashflow | 983 | 2,180 | (717) | (2,147) | (1,049) |
| Beginning cash | 4,244 | 5,228 | 7,408 | 6,691 | 4,543 |
| Ending cash | 5,228 | 7,408 | 6,691 | 4,543 | 3,494 |
| Ending net debt | (2,957) | (5,451) | (3,955) | (1,808) | (759) |

Source: Nomura estimates

Balance sheet (HK\$mn)

| As at 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & equivalents | 5,228 | 7,408 | 6,691 | 4,543 | 3,494 |
| Marketable securities | 581 | 644 | 644 | 644 | 644 |
| Accounts receivable | 157 | 243 | 316 | 359 | 501 |
| Inventories | 36 | 44 | 50 | 66 | 256 |
| Other current assets | 252 | 449 | 449 | 449 | 449 |
| Total current assets | 6,254 | 8,787 | 8,149 | 6,061 | 5,344 |
| LT investments | 6,099 | 5,946 | 10,057 | 15,329 | 20,378 |
| Fixed assets | 4,657 | 5,778 | 6,162 | 6,459 | 6,644 |
| Goodwill | | | | | |
| Other intangible assets | | | | | |
| Other LT assets | 272 | 906 | 862 | 849 | 836 |
| Total assets | 17,282 | 21,417 | 25,231 | 28,698 | 33,201 |
| Short-term debt | 1,248 | 163 | 942 | 942 | 942 |
| Accounts payable | 515 | 424 | 466 | 513 | 453 |
| Other current liabilities | 454 | 1,689 | 1,689 | 1,689 | 1,689 |
| Total current liabilities | 2,217 | 2,276 | 3,098 | 3,144 | 3,084 |
| Long-term debt | 1,022 | 1,793 | 1,793 | 1,793 | 1,793 |
| Convertible debt | | | | | |
| Other LT liabilities | 852 | 971 | 971 | 971 | 971 |
| Total liabilities | 4,092 | 5,041 | 5,862 | 5,909 | 5,849 |
| Minority interest | 2,339 | 2,165 | 2,943 | 3,917 | 5,355 |
| Preferred stock | | | | | |
| Common stock | 44 | 49 | 49 | 49 | 49 |
| Retained earnings | 10,806 | 14,161 | 16,376 | 18,823 | 21,948 |
| Proposed dividends | | | | | |
| Other equity and reserves | | | | | |
| Total shareholders' equity | 10,851 | 14,211 | 16,425 | 18,872 | 21,997 |
| Total equity & liabilities | 17,282 | 21,417 | 25,231 | 28,698 | 33,201 |

Liquidity (x)

| | | | | | |
|----------------|------|------|------|------|------|
| Current ratio | 2.82 | 3.86 | 2.63 | 1.93 | 1.73 |
| Interest cover | 47.1 | 14.2 | 25.9 | 20.7 | 29.1 |

Leverage

| | | | | | |
|---------------------|----------|----------|----------|----------|----------|
| Net debt/EBITDA (x) | net cash | net cash | net cash | net cash | net cash |
| Net debt/equity (%) | net cash | net cash | net cash | net cash | net cash |

Activity (days)

| | | | | | |
|-----------------|--------|--------|--------|--------|-------|
| Days receivable | 12.8 | 13.8 | 13.8 | 13.8 | 8.1 |
| Days inventory | 3.4 | 4.2 | 4.0 | 4.0 | 4.8 |
| Days payable | 36.4 | 50.0 | 38.0 | 33.8 | 14.5 |
| Cash cycle | (20.2) | (31.9) | (20.2) | (16.0) | (1.5) |

Source: Nomura estimates

Should maintain net cash position

Action

ENN Energy expected a slowdown in securing new gas projects in China, which prompted it to focus on new energy business and overseas projects on a long-term basis. Despite the opportunities, uncertainties prevail for the new business venture. With the opportunities and risks involved, the stock is probably at fair valuation. We raise our PT to HK\$24.1 and reiterate our NEUTRAL rating.

Catalysts

Rising gas supplies will likely be the near-term catalyst, while longer term any success from new business venture can also be a driver.

Anchor themes

We are upbeat on China's gas distribution sector, considering: 1) favourable government policies; 2) robust demand growth underpinned by the transition to clean and low-cost energy; 3) stable margins attributable to strong cost pass-through capability; and 4) potential upside from the new energy initiatives.

Risks and returns priced in

① Slowdown in securing new projects

Despite rapid growth in the past few years, the company foresees a slowdown in securing new projects, due to intense competition from peers, especially SOEs and fewer projects being available in the market. The company plans to focus on organically growing the existing business, instead of aggressively bidding for new projects.

② New business venture — energy solution provider

Together with its parent, ENN Group, the company stated it is exploring a new business venture, ie, being an energy solution provider. We view this positively. However, we are concerned about whether the parent will inject any risky/non-profitable assets (eg, solar energy) into the company.

③ Going overseas; opportunities with risks

Apart from new business ventures, the company is exploring overseas growth opportunities. Currently, it is investing in a Vietnam downstream natural gas project, with a perhaps aggressive aim to launch an IPO for the project by end 2011. The company stated it is discussing a natural gas project in the Philippines and energy solution projects in US. This implies that the company's risk profile may increase with more overseas projects, instead of being a pure China gas utilities company.

④ PT raised to HK\$24; maintain NEUTRAL

With the risks and opportunities involved, we believe the company is at fair valuation. We raise our PT to HK\$24.1 and reiterate our NEUTRAL rating.

Closing price on 2 Nov HK\$25.35

Price target **HK\$24.10**
(from HK\$21.30)

Upside/downside -4.9%

Difference from consensus **-1.4%**

FY11F net profit (RMBmn) 1,195

Difference from consensus **-10.1%**

Source: Nomura

Nomura vs consensus

We remain cautious on the investment in new business venture and the overseas projects.

Key financials & valuations

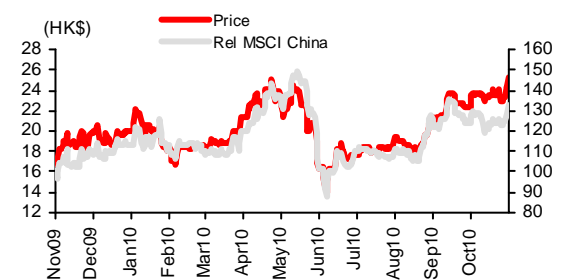
| 31 Dec (RMBmn) | FY09 | FY10F | FY11F | FY12F |
|-----------------------|-------|--------|--------|--------|
| Revenue | 8,413 | 10,853 | 14,228 | 17,396 |
| Reported net profit | 801 | 1,016 | 1,195 | 1,278 |
| Normalised net profit | 801 | 1,016 | 1,195 | 1,278 |
| Normalised EPS (RMB) | 0.78 | 0.97 | 1.14 | 1.22 |
| Norm. EPS growth (%) | 24.4 | 24.5 | 17.6 | 7.0 |
| Norm. P/E (x) | 30.2 | 23.4 | 19.0 | 17.3 |
| EV/EBITDA (x) | 12.5 | 10.6 | 8.1 | 6.7 |
| Price/book (x) | 4.5 | 3.8 | 3.1 | 2.8 |
| Dividend yield (%) | 0.8 | 1.1 | 1.4 | 1.8 |
| ROE (%) | 17.0 | 18.3 | 18.8 | 17.6 |
| Net debt/equity (%) | 61.4 | 49.9 | 29.0 | 9.3 |

Earnings revisions

| | | | |
|---------------------------|--------|--------|--------|
| Previous norm. net profit | 1,158 | 1,351 | 1,629 |
| Change from previous (%) | (12.2) | (11.5) | (21.5) |
| Previous norm. EPS (RMB) | 1.10 | 1.29 | 1.55 |

Source: Company, Nomura estimates

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|------|------|-------------|
| Absolute (HK\$) | 13.7 | 35.9 | 6.3 |
| Absolute (US\$) | 13.8 | 36.1 | 6.5 |
| Relative to Index | 7.4 | 26.0 | (4.1) |
| Market cap (US\$m) | | | 3,435 |
| Estimated free float (%) | | | 0.6 |
| 52-week range (HK\$) | | | 25.35/13.94 |
| 3-mth avg daily turnover (US\$m) | | | 6.68 |
| Stock borrowability | | | Easy |
| Major shareholders (%) | | | |
| Wang Yusuo | | | 35.9 |
| Common Wealth Bank | | | 7.9 |

Source: Company, Nomura estimates

Investment positives

New business initiatives – energy solution provider

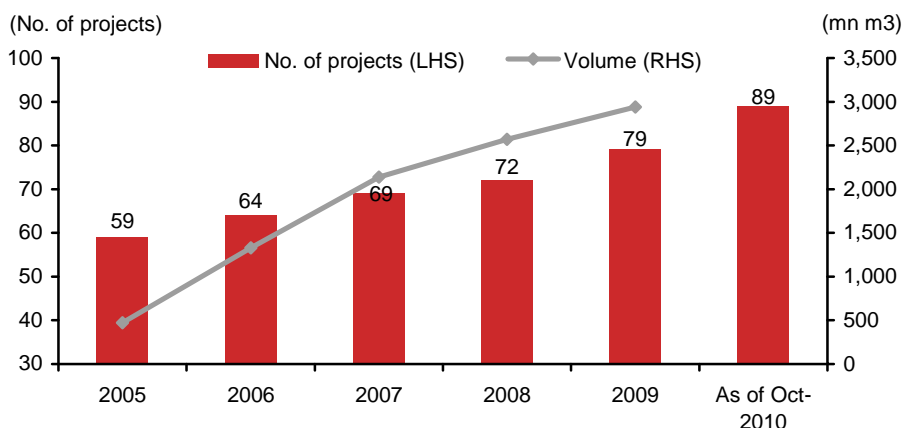
With the name change from Xinao Gas to ENN Energy (meaning “Ennovation”, ie, energy + innovation) effective from September 2010, the company plans to diversify its business scope not only as a natural gas distributor, but also as an energy services provider. Domestically, with less sizeable downstream gas projects available and intense competition from peers, especially SOEs, the company foresees a gradual slowdown in securing new projects. We remain positive on the company’s gas distribution business, given a neutral-to-positive impact from the recent wellhead price hike, together with healthy organic growth from existing projects amid increasing gas supply. With capital resources from the domestic gas business, the company is diversifying its business scope to being an energy service provider, and going overseas. We favour the company’s initiatives to diversify business scope, but prospects and profitability from the new businesses are unclear. We think the company is trading at around fair value, given its growth profile from gas business, together with the uncertainties involved in the new business.

Domestic gas business: positive fundamentals; organic growth takes the lead

With the rapid growth over the past few years (from 59 projects in 2005 to 89 projects as of Oct 2010), the company foresees a gradual slowdown in new project acquisition in the next few years. We believe this slowdown would be due mainly to: 1) intense competition, with more downstream gas players, especially from SOE companies; and 2) fewer available projects in the market.

Fewer projects may be available in the market; ENN Energy is changing its focus to organic growth

Exhibit 59. ENN Energy: historical growth – projects no. and sales volume



Source: Company data, Nomura research

Slowdown in acquisition growth

As the company is in a harvesting stage of the business cycle, it is no longer required to bid aggressively for new projects. Instead, the company said it would adhere to its minimum return guidance of IRR hurdle rate of 15% to acquire new projects. For 2H10, the company targets to have three more new projects, meaning about 12 projects in total for 2010. The company said it hopes to secure five-to-six projects pa, probably in the industrial park and more C&I-concentrated areas. The projects, however, are likely to be small-to-medium sized ones.

Organic growth driven in future

With the slowdown in acquisition growth, the company is shifting its focus towards the organic growth of existing projects. ENN’s low penetration (at average of 33.9% vs. a matured city of 80-90%) and sufficient gas supply going forward should comfortably

allow ENN's bottom line to grow at guidance of 25% in 2010 and 2011. The company expects penetration rate to grow at 5-6% every year, with 7-8 years' organic growth before market saturation.

Neutral-to-positive for wellhead price hikes

Similar to most downstream players, the June wellhead price hike poses a neutral-to-slightly-positive impact for the company. Overall, the wellhead price hike only affected 26 of ENN's 88 projects, at an average hike of RMB0.29/m³. Among the 26 projects, 15 have already received tariff adjustments, at an average of RMB0.4/m³. Public hearings still need to be conducted for adjustments for residential tariffs for the remaining 11 projects. Adjustment would be retrospective for C&I customers; whereas the residential sector, which only accounts for 15% of total revenue, may encounter several months' delay in pass through. Per ENN, although tariffs for some residential sector projects may increase less than the wellhead price hike, the price hike for C&I customers should at least fully offset the deficit, with an overall neutral-to-positive impact for the company.

Exhibit 60. ENN Energy: Progress of Tariff Pass-thru

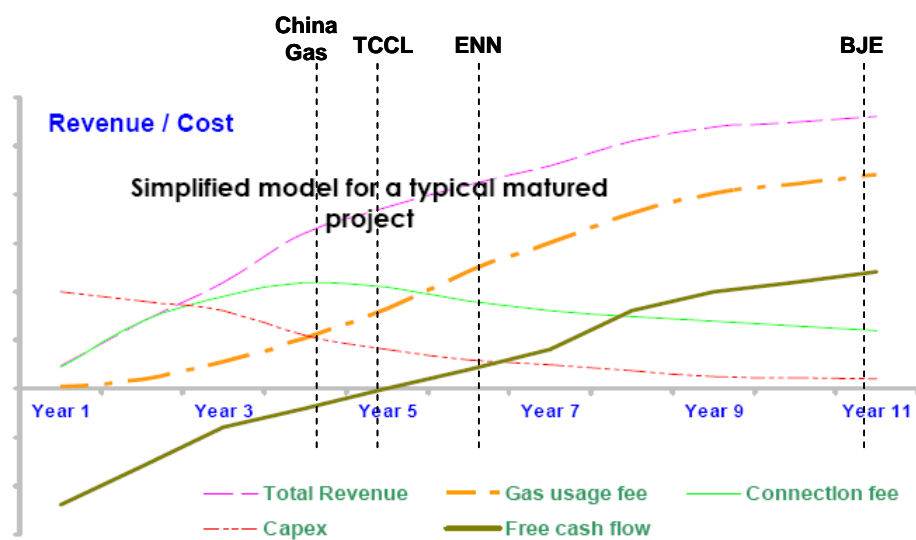
| | |
|---|------|
| Total no. of PRC projects | 88 |
| No. of projects with upstream tariff adj. | 26 |
| Average tariff increments (RMB/m ³) | 0.29 |
| No. of projects with downstream tariff adj. (incl. automatic pass thru) | 15 |
| No. of projects with automatic pass thru | 10 |
| Average tariff increments (RMB/m ³) | 0.40 |
| No. of projects pending pass thru | 11 |

Source: Company data, Nomura research

Positive free cash flow; more flexibility to pay dividend

Among downstream gas distributors, ENN Energy is the only player (apart from Beijing Enterprises, which is not a sole gas distributor) that has positive free cash flow. The positive free cash flow provides more flexibility to the company for new project acquisition and for a higher dividend to be declared. Per ENN, the company targets to raise the dividend payout ratio when free cash flow reaches RMB1bn. We expect the company to achieve this free cash flow level by 2012 and to raise its dividend payout ratio gradually to 50% from the current 20%.

Exhibit 61. The different stages of listed gas companies



Note: CR Gas is still in the asset acquisition stage, which is not included in the comparison.

Source: Nomura research

Investment concerns

New business initiatives: energy solution provider

Amid the slowdown in new project acquisitions, the company intends to diversify its business beyond natural gas distribution, to new businesses, ie, providing energy solution services together with its parent, ENN Group. Generally, the new business is that ENN Group will help the city to conserve energy and switch to cleaner and renewable energy sources by developing integrated clean energy solutions for the city. ENN Energy's role will be clean energy provision and distribution. With this, ENN Energy will change from a sole natural gas distributor to a multi-energy provider (ie, gas, power, heat, solution providers) servicing the region. Its current energy solution service projects include the Changsha Airport and some energy management projects in Guangdong, Shandong, Hebei and Henan provinces, which currently contribute several million RMB to the company's earnings. Generally, we view this as a positive move for the company to diversify its business. However, we remain concerned about: 1) whether the company has the expertise for the provision and distribution of other energy, eg, heat, power, etc.; 2) the significant change in risk profile from gas distributor to multi-energy provider; and 3) the potential injection of energy assets from the parent company (including solar energy) given the expanded business scope of the company.

Exhibit 62. ENN Energy: new business venture



Source: Company data, Nomura research

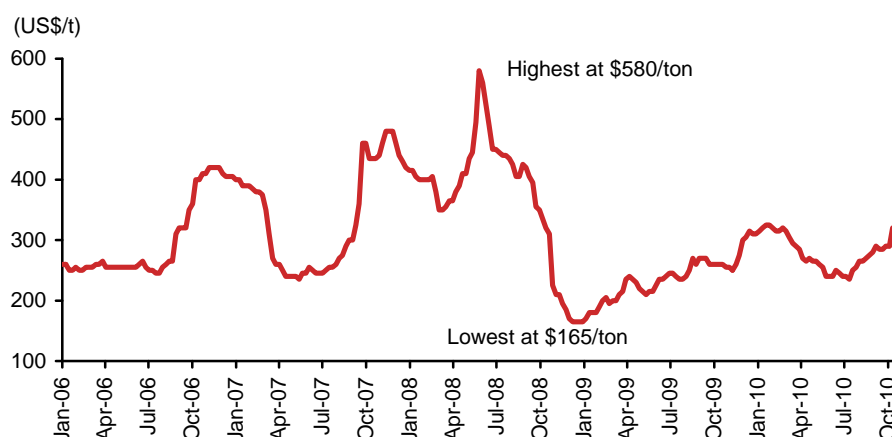
Exhibit 63. List of parent company's businesses

| Sector | Business | Nomura's comment |
|---------------------|--|---|
| Solar Energy | Manufactures high-performance solar modules and provides solar energy systems integration services for an array of clients in China and overseas | ENN Energy has stated previously that the solar energy business will not be injected into the company |
| Chemicals | Investment in coal-based mega plants that produce clean-burning fuels such as methanol, DME and methane - Ordos, Inner Mongolia - Annual methanol production capacity of 600,000 ton - Zaozhuang, Shandong Province - Annual methanol production capacity of 360,000 ton - Zhangjiagang, Jiangsu Province - Annual DME production capacity of 200,000 ton | ENN Energy owns 15% of the Ordos project. It claims it has no intention to increase its stake |
| Energy technologies | Underground coal gasification, catalytic coal gasification, carbon sequestering through bio-absorption & combined gas-power production | ENN Energy has stated that it will not be involved in the production business |
| Energy services | Works with clients to help reduce carbon footprint by conserving energy resources and improving energy efficiency | This is the business ENN Energy aims to explore |
| Capital | Financial services company operating mainly in the clean energy sector | This is not ENN Energy's targeted business scope |
| Property | Integrated real estate services in the development, construction and management of five-star hotels and exclusive golf courses | This is not ENN Energy's targeted business scope |

Source: Company data, Nomura research

Weak outlook for DME market

As stated in the table above, ENN Energy along with its parent owns 15% of a DME project, which has already commenced operation. Given the weak DME market, the project is still operating at a loss. We remain pessimistic about the DME / methanol market, due to oversupply and competition from lower-cost imported methanol. As shown below, methanol price is highly volatile, with the current price at a low level. ENN Energy stated that it would not raise its stake in the DME project. Currently, we have not factored in any value to the DME project, given the uncertainty in the business.

Exhibit 64. China: Price chart of Methanol CFR

Source: Bloomberg, Nomura research

Going overseas: opportunity or risk?

Apart from exploring new business ventures, ENN Energy is also going overseas with an investment in a Vietnam project. It has invested RMB444mn for a 44% stake in the project, with the remaining being owned by PetroVietnam (35%) and some private investors (collectively 21%). The project will start with a city gas and vehicle gas refuelling business, providing piped natural gas in Vietnam (focus on Hon Chi Minh, Hanoi and Da Ning cities) to local residents, industries and vehicles as well. The company is in a discussion with the government regarding market structure, eg, connection fee, gas tariff and gas sources and costs, etc. This business' contribution to total revenue is likely to remain marginal in the next 2-3 years. However, the company aims to launch an IPO for the Vietnam project by end 2011, which we consider very aggressive. We have not factored in the Vietnam project in our estimates, given the uncertainty of business structure and timing.

The company also aims to invest in the Philippines (in a downstream natural gas business) and the US (for the provision of energy saving solutions). Both potential projects are under discussion or feasibility study at the moment.

Among the China gas distribution players, ENN Energy is the first company to go overseas. We agree with the company's direction to diversify its business scope to relieve the negative impact from the slowdown in domestic business. However, we believe it is too early to gauge the prospects for the international business, given the risks involved and the uncertainty over returns these ventures would bring to the company. We believe the overseas business' contribution to total revenue will be immaterial for the next few years.

Share option dilution

The company granted share options to directors and management on 14 June 2010. The exercise period lasts for ~10 years, from 14 December 2010 to 13 June 2020. The exercise price of the share options is HK\$16.26, which are all in the money at the moment. We expect the share option to be gradually exercised by management, which could have some impact on the current share price level. However, the share option only represents 3.2% of the total outstanding shares, which indicates the impact should be limited. In our model, we assume all share options will be exercised.

Impact from share option dilution
not material

Exhibit 65. ENN Energy: details of share options

| Grantee | Grant date | Exercise period | Exercise price (HK\$) | No. of shares involved | % of total issued shares |
|-----------|------------|--------------------|-----------------------|------------------------|--------------------------|
| Directors | 14-Jun-10 | 14.12.10 – 13.6.20 | 16.26 | 14,810,000 | 1.41% |
| Employees | 14-Jun-10 | 14.12.10 - 13.6.20 | 16.26 | 18,680,000 | 1.78% |

Source: Company data, Nomura research

Competition from Kunlun Energy

Unlike CR Gas and Beijing Enterprises, ENN Energy has not signed any cooperation agreement with Kunlun Energy to prevent any direct competition. We may see more competition from Kunlun Energy, especially on the CNG business (focus of Kunlun Energy) in the key areas in which ENN Energy operates — Hebei, Shandong, Anhui and Hunan.

Valuation

PT of HK\$24.1; maintain NEUTRAL

We have revised our price target to HK\$24.1, which implies potential downside of 4.9%, and reiterate our NEUTRAL rating. At HK\$25.35, the company is trading at 19x FY11F P/E, which we believe is a fair value given its growth potential and the risks involved in the new business venture. We maintain NEUTRAL rating.

Our price target of HK\$24.1 is based on DCF valuation, assuming 0% terminal growth, a one-year forward FX rate of HK\$1.25:RMB1 and a WACC of 8.3%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects without a specified commencement date (such as the Vietnam project). In addition, we have not factored in any wellhead price hike, or downstream tariff hike in our assumptions, as we assume any wellhead price hike can be fully passed through to end users and a fixed dollar margin can be maintained.

Exhibit 66. ENN Energy: DCF Valuation

| ENN ENERGY HOLDINGS LTD. | | | | | | | | | | | |
|---|---------|---------|---------|---------|---------|---------|---------|---------|-------|---------|---------|
| Discounted Cash Flow Model | | | | | | | | | | | |
| RMB mn | 2011F | 2012F | 2013F | 2014F | 2015F | 2016F | 2017F | 2018F | 2019F | 2020F | 2021F |
| Free Cash Flow to the Firm | | | | | | | | | | | |
| Earnings Before Interest & Taxes (EBIT) | 2,053 | 2,220 | 2,361 | 2,560 | 2,783 | 2,848 | 2,550 | 2,753 | 2,920 | 3,070 | 3,231 |
| Taxes on EBIT: | | | | | | | | | | | |
| Add: Income taxes from income statement | 536 | 573 | 644 | 702 | 773 | 801 | 737 | 800 | 853 | 901 | 951 |
| Add: Tax shield on interest expenses | 105 | 116 | 102 | 112 | 122 | 132 | 141 | 150 | 159 | 167 | 175 |
| Less: Tax on Interest Income | (10) | (15) | (21) | (23) | (29) | (36) | (42) | (48) | (53) | (59) | (65) |
| Less: Tax on non-operating income | (19) | - | - | - | - | - | - | - | - | - | - |
| Total Taxes on EBIT | (612) | (674) | (725) | (791) | (866) | (897) | (836) | (903) | (958) | (1,008) | (1,061) |
| Minority Interest | (412) | (441) | (495) | (540) | (594) | (616) | (567) | (615) | (656) | (693) | (732) |
| Change in deferred income taxes | - | - | - | - | - | - | - | - | - | - | - |
| Goodwill Amortization | - | - | - | - | - | - | - | - | - | - | - |
| Dividend from JCE and associates | 156 | 188 | 213 | 240 | 268 | 293 | 313 | 339 | 361 | 381 | 401 |
| Net Operating Profits After Taxes, NOPAT | 1,185 | 1,294 | 1,354 | 1,468 | 1,592 | 1,628 | 1,461 | 1,575 | 1,667 | 1,750 | 1,839 |
| Depreciation & Amortization (except goodwill) | 526 | 577 | 620 | 662 | 701 | 739 | 776 | 814 | 850 | 884 | 918 |
| Net Change in Working Capital | 651 | 628 | 415 | 506 | 559 | 465 | 609 | 451 | 388 | 341 | 372 |
| Net Capital Expenditures | (1,500) | (1,200) | (1,100) | (1,100) | (1,000) | (1,000) | (1,000) | (1,000) | (900) | (900) | (900) |
| Free Cash Flows to the Firm (FCFF) | 862 | 1,299 | 1,289 | 1,536 | 1,852 | 1,832 | 1,847 | 1,840 | 2,004 | 2,075 | 2,229 |
| Key Assumption | | | | | | | | | | | |
| Risk Free Rate | 2.5% | | | | | | | | | | |
| Beta | 0.93 | | | | | | | | | | |
| Market risk premium (rm - rf) | 7.5% | | | | | | | | | | |
| Cost of Equity (re) | 9.4% | | | | | | | | | | |
| Cost of Preferred Equity (rp) | 0.0% | | | | | | | | | | |
| Cost of Debt | 6.5% | | | | | | | | | | |
| Effective Tax Rate | 25.0% | | | | | | | | | | |
| Market Value Preferred Stock/E Ratio | 0.0% | | | | | | | | | | |
| Market Value D/E Ratio | 25.0% | | | | | | | | | | |
| Weight Average Cost of Capital (WACC) | 8.3% | | | | | | | | | | |
| Terminal Growth Rate | 0.0% | | | | | | | | | | |
| Sensitivity table 1 | | | | | | | | | | | |
| ---Terminal Growth Rate--- | | | | | | | | | | | |
| | 0.00% | 0.25% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% | 1.75% | | | |
| 6.00% | 35.50 | 36.60 | 37.80 | 39.12 | 40.56 | 42.16 | 43.93 | 45.92 | | | |
| 6.25% | 33.84 | 34.83 | 35.91 | 37.08 | 38.37 | 39.78 | 41.34 | 43.08 | | | |
| 6.50% | 32.31 | 33.20 | 34.17 | 35.22 | 36.37 | 37.63 | 39.02 | 40.55 | | | |
| 6.75% | 30.89 | 31.70 | 32.58 | 33.52 | 34.56 | 35.68 | 36.91 | 38.27 | | | |
| 7.00% | 29.57 | 30.31 | 31.11 | 31.96 | 32.89 | 33.90 | 35.01 | 36.21 | | | |
| 7.25% | 28.35 | 29.03 | 29.75 | 30.53 | 31.37 | 32.28 | 33.27 | 34.34 | | | |
| 7.50% | 27.22 | 27.83 | 28.49 | 29.20 | 29.96 | 30.78 | 31.67 | 32.64 | | | |
| 7.75% | 26.15 | 26.72 | 27.32 | 27.96 | 28.66 | 29.40 | 30.21 | 31.08 | | | |
| 8.00% | 25.16 | 25.68 | 26.23 | 26.82 | 27.45 | 28.13 | 28.86 | 29.65 | | | |
| 8.25% | 24.23 | 24.70 | 25.21 | 25.75 | 26.33 | 26.95 | 27.61 | 28.33 | | | |
| 8.50% | 23.35 | 23.79 | 24.26 | 24.75 | 25.28 | 25.85 | 26.46 | 27.11 | | | |
| 8.75% | 22.53 | 22.94 | 23.37 | 23.82 | 24.31 | 24.83 | 25.38 | 25.97 | | | |
| 9.00% | 21.76 | 22.13 | 22.53 | 22.95 | 23.39 | 23.87 | 24.38 | 24.92 | | | |
| 9.25% | 21.02 | 21.37 | 21.74 | 22.13 | 22.54 | 22.98 | 23.44 | 23.94 | | | |
| 9.50% | 20.33 | 20.65 | 20.99 | 21.35 | 21.73 | 22.14 | 22.57 | 23.02 | | | |
| 9.75% | 19.67 | 19.97 | 20.29 | 20.62 | 20.98 | 21.35 | 21.74 | 22.16 | | | |
| 10.00% | 19.05 | 19.33 | 19.63 | 19.93 | 20.26 | 20.61 | 20.97 | 21.36 | | | |
| 10.25% | 18.46 | 18.72 | 19.00 | 19.28 | 19.59 | 19.91 | 20.24 | 20.60 | | | |
| Discounted Free Cash Flow Valuation | | | | | | | | | | | |
| PV of FCFF during 2011-20 | 10,358 | | | | | | | | | | |
| Continuing value based on cash flows beyond Year 2020 | 12,107 | | | | | | | | | | |
| Total Enterprise Value (Operating Value) | 22,465 | | | | | | | | | | |
| Add: Excess Cash & Non-operating Investments | 5,197 | | | | | | | | | | |
| Cash expected to be received from exercise of share options | 437 | | | | | | | | | | |
| Total Firm Value | 28,099 | | | | | | | | | | |
| Equity Valuation | | | | | | | | | | | |
| Total Firm Value | 28,099 | | | | | | | | | | |
| Less: Value of Interest Bearing Debt | 7,173 | | | | | | | | | | |
| Less: Value of Preferred Stock | - | | | | | | | | | | |
| Value of Common Equity | 20,926 | | | | | | | | | | |
| No. of Shares | | | | | | | | | | | |
| Number of Share Outstanding (mn) | 1,050 | | | | | | | | | | |
| Share options exercise (mn) | 33 | | | | | | | | | | |
| Total diluted no. of shares (mn) | 1,084 | | | | | | | | | | |
| Equity Value per share (RMB) | 19.31 | | | | | | | | | | |
| Equity Value per share (HK\$) | 24.06 | | | | | | | | | | |

Source: Nomura estimates

Investment risks

Downside risks to our price target include: 1) slower-than-expected new connection and gas sales growth; 2) margin squeeze by cost pass-through delay and 3) value-destructive asset injection / acquisition. We note, however, that ENN should be relatively unaffected by the wellhead price increase, since only 26 projects out of its 88 projects have wellhead price hike (average at RMB0.29/m3), and 15 projects have already received average downstream price hike of RMB0.4/m3. For the remaining 11 projects, downstream price hike for C&I users will be implemented retrospectively; whereas for residential customers, public hearing is required before any adjustment. We believe any impact from cost pass through delay in residential sector tariff hikes should be minimal, given residential only accounts for around 15% of the total revenue.

Upside risks include: 1) higher-than-expected gas volume sales to higher margin C&I and vehicle users; 2) value-constructive asset injection / acquisition; and 3) possibility of being an acquisition target amid industry consolidation in the long-term.

Exhibit 67. ENN Energy: Project details (I)

| Project detail | Operational location | Incorporation year | Installed capacity (m3/day) | Residential households | C&I customers | C&I customers capacity (m3) | No. of CNG stations |
|----------------|-------------------------|--------------------|-----------------------------|------------------------|---------------|-----------------------------|---------------------|
| Hebei | Langfang | 1993 | 410 | 141,338 | 685 | 423,584 | 4 |
| | Shijiazhuang | 2002 | 602 | 479,204 | 658 | 616,761 | 17 |
| | Luquan | 2004 | 1,800 | 9,609 | 2 | 1,670 | - |
| | Luanxian | 2009 | - | - | - | - | - |
| Shandong | Liaocheng | 2000 | 100 | 92,320 | 370 | 97,211 | 4 |
| | Huangdao | 2001 | 72 | 95,080 | 151 | 564,363 | 2 |
| | Zhucheng | 2001 | - | 41,640 | 73 | 24,052 | - |
| | Chengyang | 2001 | 400 | 116,542 | 206 | 203,755 | 3 |
| | Yantai Development Zone | 2001 | 30 | - | 1 | 12,000 | - |
| | Yantai | 2004 | 340 | 257,325 | 466 | 773,170 | 6 |
| | Zouping | 2002 | 130 | 20,336 | 55 | 125,204 | - |
| | Laiyang | 2002 | 72 | 34,650 | 87 | 34,782 | 1 |
| | Rizhao | 2002 | 300 | 69,456 | 101 | 80,589 | 1 |
| | Jiaozhou | 2003 | 40 | 49,502 | 110 | 182,370 | 1 |
| | Jiaonan | 2003 | 120 | 35,503 | 38 | 110,394 | 1 |
| Beijing | Miyun | 2000 | 168 | 44,874 | 161 | 110,403 | - |
| | Pinggu | 2001 | 72 | 23,707 | 116 | 99,002 | - |
| | Changping | 2001 | 102 | 37,573 | 256 | 72,371 | - |
| Liaoning | Huludao | 2000 | 30 | 122,793 | 254 | 120,434 | 3 |
| | Xincheng | 2002 | - | - | - | - | - |
| Jiangsu | Gaoyou | 2001 | 5 | 19,197 | 120 | 15,688 | - |
| | Taixing | 2002 | 396 | 25,198 | 273 | 87,002 | - |
| | Yancheng | 2002 | 30 | 89,098 | 367 | 231,787 | 2 |
| | Huaian | 2002 | 70 | 101,358 | 208 | 195,746 | 3 |
| | Haian | 2002 | 4 | 19,118 | 119 | 38,907 | - |
| | Xinghua | 2002 | 50 | 16,972 | 93 | 16,545 | - |
| | Wujin | 2003 | 430 | 93,638 | 709 | 922,036 | 6 |
| | Lianyungang | 2003 | 200 | 137,180 | 286 | 245,242 | 4 |
| Zhejiang | Haining | 2002 | 396 | 28,235 | 121 | 130,225 | - |
| | Quzhou | 2002 | 280 | 39,236 | 115 | 73,111 | - |
| | Lanxi | 2003 | - | 7,343 | 36 | 10,163 | - |
| | Jinhua | 2003 | 210 | 34,568 | 127 | 51,158 | - |
| | Wenzhou | 2003 | 120 | 8,877 | 29 | 53,031 | - |
| | Wenzhou Longwan | 2004 | - | 476 | - | - | - |
| | Huzhou | 2004 | 620 | 53,830 | 122 | 129,428 | 1 |
| | Huangyan, Taizhou | 2005 | - | 22,477 | 55 | 18,650 | - |

Source: Company data, Nomura research

Exhibit 68. ENN Energy: Project details (II)

| Project details | Operational location | Incorporation year | Installed capacity (m3/day) | Residential households | C&I customers | C&I customers capacity (m3) | No. of CNG stations |
|-----------------------|---------------------------|--------------------|-----------------------------|------------------------|---------------|-----------------------------|---------------------|
| | Yongkang | 2005 | 120 | 7,668 | 69 | 73,563 | - |
| | Xiaoshan | 1994 | - | 86,646 | 131 | 133,959 | - |
| | Ningbo, Yinzhou | 2007 | - | 70,901 | 231 | 61,783 | - |
| | Haiyan | 2008 | - | - | - | - | - |
| | Longyou | 2009 | - | 1,597 | - | - | - |
| | Huzhou Nanxun | 2009 | - | - | - | - | - |
| Fujian | Quanzhou | 2006 | 567 | 18,181 | 70 | 53,821 | 1 |
| | Nanan | 2006 | 120 | 1,522 | 7 | 114,150 | - |
| | Huian | 2006 | - | 3,949 | 20 | 20,970 | - |
| | Shishi | 2006 | - | 4,848 | 56 | 10,677 | - |
| | Jinjiang | 2006 | 100 | 13,430 | 117 | 546,370 | - |
| | Dehua | 2003 | 240 | 824 | 170 | 165,980 | - |
| | Quangang | 2008 | - | - | - | - | - |
| | Yongchun | 2009 | - | - | - | - | - |
| Guangdong | Dongguan | 2003 | 460 | 160,868 | 957 | 1,054,646 | 8 |
| | Zhanjiang | 2004 | 360 | 43,778 | 181 | 230,292 | 2 |
| | Shantou | 2004 | 180 | 28,954 | 90 | 72,919 | - |
| | Zhaoqing Development Zone | 2005 | 25 | 555 | 10 | 63,215 | - |
| | Zhaoqing | 2008 | 12 | 6,167 | 23 | 18,590 | - |
| | Guangzhou Zengcheng | 2007 | - | 29,057 | 10 | 798 | - |
| | Sihui | 2009 | - | - | - | - | - |
| Inner Mongolia | Tongliao | 2004 | 50 | 49,796 | 69 | 20,315 | 1 |
| Henan | Xinxiang | 2002 | 500 | 148,428 | 479 | 277,747 | 5 |
| | Kaifeng | 2003 | 220 | 158,219 | 739 | 198,838 | 1 |
| | Shangqiu | 2004 | 240 | 37,318 | 162 | 16,682 | 2 |
| | Luoyang | 2006 | 1,000 | 135,342 | 520 | 813,206 | 3 |
| | Xinan | 2007 | - | 1,764 | 1 | 350 | - |
| | Yichuan | 2009 | - | - | - | - | - |
| Anhui | Bengbu | 2002 | 96 | 110,025 | 241 | 312,693 | 6 |
| | Chuzhou | 2002 | 270 | 55,444 | 210 | 308,025 | 2 |
| | Lu'an | 2003 | 60 | 50,958 | 96 | 30,418 | 3 |
| | Bozhou | 2003 | 46 | 17,788 | 76 | 16,584 | 2 |
| | Chaohu | 2003 | 120 | 43,666 | 144 | 78,712 | 2 |
| | Fengyang | 2005 | - | 116 | 8 | 79,750 | 1 |
| | Laian | 2006 | - | 6,782 | 25 | 47,880 | - |
| | Qianjiang | 2007 | - | 12,933 | 40 | 16,081 | - |
| | Guzhen | 2007 | - | - | 1 | 5,000 | - |

Source: Company data, Nomura research

Exhibit 69. ENN Energy: Project details (III)

| Project details | Operational location | Incorporation year | Installed capacity (m3/day) | Residential households | C&I customers | C&I customers capacity (m3) | No. of CNG stations |
|-------------------|---------------------------------------|--------------------|-----------------------------|------------------------|---------------|-----------------------------|---------------------|
| Anhui | Bengbu | 2002 | 96 | 110,025 | 241 | 312,693 | 6 |
| | Chuzhou | 2002 | 270 | 55,444 | 210 | 308,025 | 2 |
| | Lu'an | 2003 | 60 | 50,958 | 96 | 30,418 | 3 |
| | Bozhou | 2003 | 46 | 17,788 | 76 | 16,584 | 2 |
| | Chaohu | 2003 | 120 | 43,666 | 144 | 78,712 | 2 |
| | Fengyang | 2005 | - | 116 | 8 | 79,750 | 1 |
| | Laian | 2006 | - | 6,782 | 25 | 47,880 | - |
| | Qianjiao | 2007 | - | 12,933 | 40 | 16,081 | - |
| | Guzhen | 2007 | - | - | 1 | 5,000 | - |
| Hunan | Xiangtan | 2003 | 180 | 127,042 | 495 | 236,852 | 4 |
| | Changsha | 2003 | 1,633 | 530,911 | 1,042 | 1,431,696 | 8 |
| | Zhuzhou | 2003 | 100 | 297,386 | 836 | 1,037,547 | 3 |
| Guangxi | Guilin | 2004 | 240 | 61,692 | 61 | 35,396 | 1 |
| | Guigang | 2004 | 100 | 13,855 | 63 | 30,100 | - |
| Jiangxi | Nanchang Shanghai | 2009 | - | - | - | - | - |
| Under development | Luoding, Guangdong | 2010 | | | | | |
| | Fengkai, Guangdong | 2010 | | | | | |
| | Guangning, Guangdong | 2010 | | | | | |
| | Huaiji, Guangdong | 2010 | | | | | |
| | Lianzhou, Guangdong | 2010 | | | | | |
| | Huadu, Guangdong | 2010 | | | | | |
| | Huaihua, Hunan | 2010 | | | | | |
| | Wenshan, Yunnan | 2010 | | | | | |
| | Xinyi, Guangdong | 2010 | | | | | |
| | Hanoi, Vietnam | 2010 | | | | | |
| | Ho Chi Minh, Vietnam | 2010 | | | | | |
| | Da Nang, Vietnam | 2010 | | | | | |
| Other project | Shanghai (CNG) | 2002 | | | | | |
| | Shanghai (LPG) | 2007 | | | | | |
| | Shanghai (DME) | 2007 | | | | | |
| | Other gas refuelling station projects | | | | | | |

Source: Company data, Nomura research

Financial statements

| Income statement (RMBmn) | | | | | |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Revenue | 8,266 | 8,413 | 10,853 | 14,228 | 17,396 |
| Cost of goods sold | (6,019) | (5,875) | (7,905) | (10,497) | (13,087) |
| Gross profit | 2,247 | 2,538 | 2,948 | 3,732 | 4,309 |
| SG&A | (1,062) | (939) | (1,254) | (1,679) | (2,088) |
| Employee share expense | - | - | - | - | - |
| Operating profit | 1,184 | 1,599 | 1,694 | 2,053 | 2,220 |
| EBITDA | 1,497 | 1,990 | 2,153 | 2,579 | 2,797 |
| Depreciation | (276) | (357) | (425) | (491) | (542) |
| Amortisation | (37) | (33) | (35) | (35) | (35) |
| EBIT | 1,184 | 1,599 | 1,694 | 2,053 | 2,220 |
| Net interest expense | (351) | (308) | (317) | (381) | (405) |
| Associates & JCEs | 200 | 216 | 308 | 395 | 476 |
| Other income | 97 | (126) | 45 | 75 | - |
| Earnings before tax | 1,131 | 1,381 | 1,730 | 2,142 | 2,292 |
| Income tax | (260) | (304) | (363) | (536) | (573) |
| Net profit after tax | 871 | 1,077 | 1,367 | 1,607 | 1,719 |
| Minority interests | (240) | (276) | (350) | (412) | (441) |
| Other items | - | - | - | - | - |
| Preferred dividends | - | - | - | - | - |
| Normalised NPAT | 631 | 801 | 1,016 | 1,195 | 1,278 |
| Extraordinary items | - | - | - | - | - |
| Reported NPAT | 631 | 801 | 1,016 | 1,195 | 1,278 |
| Dividends | (158) | (200) | (254) | (299) | (383) |
| Transfer to reserves | 473 | 600 | 762 | 896 | 895 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 39.0 | 30.2 | 23.4 | 19.0 | 17.3 |
| FD normalised P/E at price target (x) | 37.1 | 28.7 | 22.3 | 18.1 | 16.4 |
| Reported P/E (x) | 38.4 | 29.6 | 22.7 | 18.4 | 16.7 |
| Dividend yield (%) | 0.7 | 0.8 | 1.1 | 1.4 | 1.8 |
| Price/cashflow (x) | 19.3 | 10.8 | 8.8 | 7.5 | 7.0 |
| Price/book (x) | 5.6 | 4.5 | 3.8 | 3.1 | 2.8 |
| EV/EBITDA (x) | 17.0 | 12.5 | 10.6 | 8.1 | 6.7 |
| EV/EBIT (x) | 20.9 | 15.1 | 13.0 | 9.8 | 8.2 |
| Gross margin (%) | 27.2 | 30.2 | 27.2 | 26.2 | 24.8 |
| EBITDA margin (%) | 18.1 | 23.6 | 19.8 | 18.1 | 16.1 |
| EBIT margin (%) | 14.3 | 19.0 | 15.6 | 14.4 | 12.8 |
| Net margin (%) | 7.6 | 9.5 | 9.4 | 8.4 | 7.3 |
| Effective tax rate (%) | 23.0 | 22.0 | 21.0 | 25.0 | 25.0 |
| Dividend payout (%) | 25.0 | 25.0 | 25.0 | 25.0 | 30.0 |
| Capex to sales (%) | 14.3 | 18.3 | 18.4 | 10.5 | 6.9 |
| Capex to depreciation (x) | 4.3 | 4.3 | 4.7 | 3.1 | 2.2 |
| ROE (%) | 15.8 | 17.0 | 18.3 | 18.8 | 17.6 |
| ROA (pretax %) | 11.7 | 13.6 | 13.3 | 14.3 | 14.4 |
| Growth (%) | | | | | |
| Revenue | 43.6 | 1.8 | 29.0 | 31.1 | 22.3 |
| EBITDA | 49.0 | 32.9 | 8.2 | 19.8 | 8.5 |
| EBIT | 51.8 | 35.0 | 5.9 | 21.2 | 8.1 |
| Normalised EPS | 21.9 | 24.4 | 24.5 | 17.6 | 7.0 |
| Normalised FDEPS | 22.1 | 24.2 | 23.0 | 17.6 | 7.0 |
| Per share | | | | | |
| Reported EPS (RMB) | 0.63 | 0.78 | 0.97 | 1.14 | 1.22 |
| Norm EPS (RMB) | 0.63 | 0.78 | 0.97 | 1.14 | 1.22 |
| Fully diluted norm EPS (RMB) | 0.61 | 0.76 | 0.94 | 1.10 | 1.18 |
| Book value per share (RMB) | 4.21 | 4.92 | 5.64 | 6.49 | 7.35 |
| DPS (RMB) | 0.16 | 0.19 | 0.24 | 0.28 | 0.37 |

Source: Nomura estimates

Cashflow (RMBmn)

| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| EBITDA | 1,497 | 1,990 | 2,153 | 2,579 | 2,797 |
| Change in working capital | 168 | 563 | 612 | 651 | 628 |
| Other operating cashflow | (413) | (346) | (145) | (302) | (369) |
| Cashflow from operations | 1,252 | 2,207 | 2,621 | 2,928 | 3,056 |
| Capital expenditure | (1,186) | (1,541) | (2,000) | (1,500) | (1,200) |
| Free cashflow | 66 | 665 | 621 | 1,428 | 1,856 |
| Reduction in investments | 32 | (10) | - | - | - |
| Net acquisitions | (137) | (100) | - | - | - |
| Reduction in other LT assets | (61) | (438) | (186) | (239) | (288) |
| Addition in other LT liabilities | 60 | 290 | 218 | 233 | 204 |
| Adjustments | (110) | 112 | 122 | 201 | 334 |
| Cashflow after investing acts | (150) | 520 | 775 | 1,623 | 2,106 |
| Cash dividends | (247) | (309) | (254) | (299) | (383) |
| Equity issue | - | 237 | - | - | - |
| Debt issue | 404 | 732 | 342 | 946 | 854 |
| Convertible debt issue | | | | | |
| Others | 26 | (192) | (305) | (344) | (466) |
| Cashflow from financial acts | 182 | 467 | (216) | 303 | 5 |
| Net cashflow | 32 | 987 | 559 | 1,926 | 2,111 |
| Beginning cash | 1,693 | 1,725 | 2,713 | 3,271 | 5,197 |
| Ending cash | 1,725 | 2,713 | 3,271 | 5,197 | 7,308 |
| Ending net debt | 3,678 | 3,172 | 2,956 | 1,976 | 719 |

Source: Nomura estimates

Balance sheet (RMBmn)

| As at 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & equivalents | 1,725 | 2,713 | 3,271 | 5,197 | 7,308 |
| Marketable securities | - | - | - | - | - |
| Accounts receivable | 1,431 | 1,208 | 1,559 | 2,044 | 2,498 |
| Inventories | 254 | 286 | 385 | 511 | 637 |
| Other current assets | 866 | 547 | 537 | 563 | 547 |
| Total current assets | 4,277 | 4,754 | 5,752 | 8,315 | 10,990 |
| LT investments | 63 | 73 | 73 | 73 | 73 |
| Fixed assets | 7,855 | 9,092 | 10,667 | 11,676 | 12,334 |
| Goodwill | 169 | 172 | 172 | 172 | 172 |
| Other intangible assets | 937 | 979 | 944 | 910 | 875 |
| Other LT assets | 1,196 | 1,634 | 1,821 | 2,059 | 2,347 |
| Total assets | 14,497 | 16,703 | 19,429 | 23,204 | 26,790 |
| Short-term debt | 1,869 | 1,484 | 872 | 1,143 | 1,397 |
| Accounts payable | 2,752 | 2,772 | 3,729 | 4,952 | 6,174 |
| Other current liabilities | 730 | 1,108 | 1,202 | 1,268 | 1,239 |
| Total current liabilities | 5,351 | 5,364 | 5,803 | 7,363 | 8,810 |
| Long-term debt | 3,534 | 4,400 | 5,355 | 6,030 | 6,630 |
| Convertible debt | - | - | - | - | - |
| Other LT liabilities | 171 | 461 | 679 | 913 | 1,116 |
| Total liabilities | 9,056 | 10,225 | 11,838 | 14,305 | 16,556 |
| Minority interest | 1,186 | 1,316 | 1,667 | 2,079 | 2,519 |
| Preferred stock | - | - | - | - | - |
| Common stock | 106 | 110 | 110 | 110 | 110 |
| Retained earnings | 3,992 | 4,852 | 5,560 | 6,412 | 7,222 |
| Proposed dividends | 158 | 200 | 254 | 299 | 383 |
| Other equity and reserves | - | - | - | - | - |
| Total shareholders' equity | 4,256 | 5,162 | 5,924 | 6,820 | 7,715 |
| Total equity & liabilities | 14,497 | 16,703 | 19,429 | 23,204 | 26,790 |

Liquidity (x)

| | | | | | |
|----------------|------|------|------|------|------|
| Current ratio | 0.80 | 0.89 | 0.99 | 1.13 | 1.25 |
| Interest cover | 3.4 | 5.2 | 5.3 | 5.4 | 5.5 |

Leverage

| | | | | | |
|---------------------|------|------|------|------|------|
| Net debt/EBITDA (x) | 2.46 | 1.59 | 1.37 | 0.77 | 0.26 |
| Net debt/equity (%) | 86.4 | 61.4 | 49.9 | 29.0 | 9.3 |

Activity (days)

| | | | | | |
|-----------------|--------|--------|--------|--------|--------|
| Days receivable | 55.4 | 57.3 | 46.5 | 46.2 | 47.8 |
| Days inventory | 14.9 | 16.8 | 15.5 | 15.6 | 16.1 |
| Days payable | 150.7 | 171.6 | 150.1 | 150.9 | 155.6 |
| Cash cycle | (80.5) | (97.6) | (88.1) | (89.2) | (91.7) |

Source: Nomura estimates

Action

Despite an asset injection story similar to that of CR Gas, Towngas China fails to excite us to the same extent, since any injection will be done at fair value. We do not see any near-term catalysts driving share price performance from the current level. Solely on valuation, we upgrade to NEUTRAL, and revise our PT to HK\$3.4.

Catalysts

Lack of near-term catalysts, except for a value-accretive asset injection from the parent, which we consider as highly unlikely to happen.

Anchor themes

We are upbeat on China's gas distribution sector, considering: 1) favourable government policies; 2) robust demand growth underpinned by the transition to clean and low-cost energy; 3) stable margins attributable to strong cost pass-through capability; and 4) potential upside from the new energy initiatives.

Waiting for the next catalyst

① Future asset injection by parent, but unattractive

Despite Towngas China and CR Gas both being recipients of asset injections from their parent firms, we are of the view that Towngas China is not as attractive as CR Gas as we believe any injection will be done at fair market value which is not expected to be value accretive to Towngas China. The only benefit, in our view, is the company will grow bigger. In the long run, per the company, Towngas China will be the sole platform of HKCG's China investment. But no specific timeline is given for this direction.

② Delay in wellhead price hikes pass-through

We believe the company will slightly suffer from the delay in passing through the wellhead price hikes, given only 40% of the residential customers have completed the pass-through process, which is the lowest percentage among the gas distribution companies.

③ Short-term pressure from potential disposal by EnerChina

EnerChina, which currently owns 18.19% of Towngas China, set a mandate in May 2010 to dispose of the remaining shares of Towngas China. Despite EnerChina providing no timeline for the disposal, we believe a disposal could exert short-term pressure on the stock. On a longer-term basis, we view this as positive, given the disposal can increase the free float of the company.

④ PT revised up to HK\$3.4; upgrade to NEUTRAL

At HK\$3.56, the company is trading at 18.5x FY11F basic P/E, vs its peers at 19.6x. We do not foresee any near-term catalysts to drive the share price performance from the current level. We revised up our PT to HK\$3.4, with a NEUTRAL rating, implying downside potential of 4.5%.

| | |
|---------------------------|------------------------------------|
| Closing price on 2 Nov | HK\$3.56 |
| Price target | HK\$3.40 (from HK\$2.20) |
| Upside/downside | -4.5% |
| Difference from consensus | -8.4% |
| FY11F net profit (HK\$m) | 469.9 |
| Difference from consensus | -8.9% |
| Source: Nomura | |

Nomura vs consensus

Although the market expects parent assets to be injected into the company, we do not expect any value-accretive asset injections to be made.

Key financials & valuations

| 31 Dec (HK\$m) | FY09 | FY10F | FY11F | FY12F |
|---------------------------|-------|-------|-------|-------|
| Revenue | 2,025 | 2,749 | 3,530 | 4,109 |
| Reported net profit | 265 | 352 | 470 | 573 |
| Normalised net profit | 265 | 352 | 470 | 573 |
| Normalised EPS (HK\$) | 0.14 | 0.16 | 0.19 | 0.23 |
| Norm. EPS growth (%) | 31.0 | 18.2 | 20.2 | 21.9 |
| Norm. P/E (x) | 26.3 | 22.6 | 18.8 | 15.4 |
| EV/EBITDA (x) | 15.7 | 12.1 | 9.8 | 8.3 |
| Price/book (x) | 1.1 | 1.0 | 1.0 | 0.9 |
| Dividend yield (%) | 0.6 | 0.8 | 1.1 | 1.3 |
| ROE (%) | 3.8 | 4.4 | 5.1 | 5.9 |
| Net debt/equity (%) | 28.0 | 20.6 | 18.3 | 14.8 |
| Earnings revisions | | | | |
| Previous nom. net profit | | 312.4 | 367.8 | na |
| Change from previous (%) | | 12.7 | 27.8 | na |
| Previous nom. EPS (HK\$) | | 0.157 | 0.184 | na |

Source: Company, Nomura estimates

Share price relative to MSCI China



Drilling down

Long-term: Sole China platform for HKCG

Despite potential asset injection from the parent Hong Kong & China Gas (HKCG), valuation will only be done at fair market value and we believe it will not be value accretive to Towngas China. In the long term, Towngas China will be the sole China platform of HKCG (no specific timeline given by the company). We upgrade our rating to NEUTRAL from Reduce, solely on valuation, and revised our price target to HK\$3.4, with downside potential of 4.5%.

Unattractive asset injection story

Despite an asset injection story similar to CR Gas, Towngas China fails to excite us to the same extent as any injection will be done at fair value. Given HKCG and Towngas China are listed companies, all the transactions are required to be done at fair value to balance the benefits for both parties. In the previous two transactions (please see table below for details) they were done at full value.

Same parent asset injection story, but at different valuation – not attractive in our view

Exhibit 70. Towngas China: Valuation for past asset injections

| Date | Projects | Consideration | Valuation - P/E (x) | | | |
|--------|--|---------------|---------------------|------|---------------|----------|
| | | (HK\$mn) | Acquisition | HKCG | Towngas China | Industry |
| Dec-06 | 10 projects in Qingdao, Zibo, Longkou, Weifang, Weihai, Taian, Maanshan & Anqing | 3,231 | 147.0 | 18.2 | 24.4 | 100.3 |
| Mar-10 | 6 projects in Liaoning & Zhejiang provinces | 1,722 | 26.8 | 23.9 | 26.3 | 25.7 |

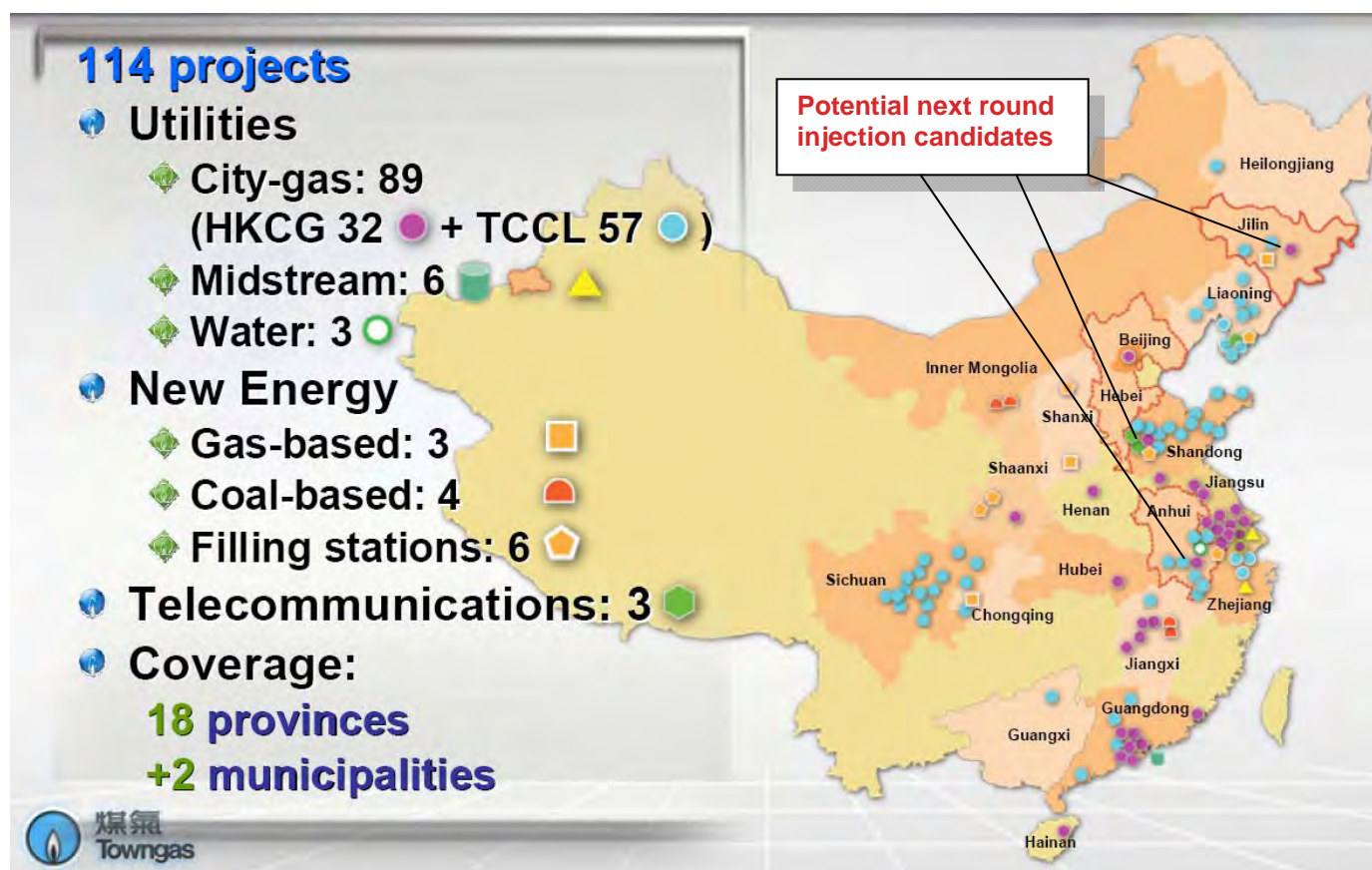
Source: Company data, Nomura research

Following the same principle, we believe any future injection from HKCG will not be value accretive to Towngas China. No timeline has been set for the next round of asset injection, but we believe any asset injection will be subject to the valuation of the two companies, i.e. asset injection is likely to take place when the valuation gap between the two companies is narrow so that the transaction can be done at a fair valuation to both parties. Among the projects from parent, we expect the potential candidates for next round of asset injection could be Tongling in Anhui, Jinan East in Shandong and Jilin in Northern China, as these are the existing key presence of Towngas China.

Zero-sum game; Fair Value Injection

Apart from asset injections from the parent, the company has a target to secure 5-6 projects every year. For 2010, the company has already secured four projects, apart from the injection of six projects from the parent company. On a long-term basis, Towngas China will be the sole China platform for the HKCG Group, despite no specific timeline given by the company.

Exhibit 71. Towngas China: Potential next round injection candidates from HKCG



Source: Nomura International (Hong Kong) Limited

Delay for wellhead price hikes pass through

Among downstream gas players, the pass-through situation for Towngas China is not very favourable. Similar to other players, the company has already passed through the increased gas costs to 60% of its C&I customers, at the magnitude of around RMB0.3-0.35/m³ and applied retrospectively, i.e. starting from 1 June 2010. However, for residential users, the company is still in the process of public hearing for the pass through and only 40% of the residential users have been done as of today. Despite the company expecting the majority of the remaining pass-through to be completed by end-2010, the delay may result in short-term margin squeeze for the company.

Potential stake disposal by EnerChina

EnerChina owns 445mn shares of Towngas China, which translates to about 18.19% of the total outstanding shares of Towngas China. In May 2010, EnerChina set itself a mandate to dispose of the remaining shares of Towngas China. The mechanism for setting the selling price is: 1) the selling price should not represent more than a 20% discount to the average closing price of Towngas China shares in the five trading days immediately prior to the date of the sale and purchase agreement; or 2) whether the minimum selling price per share shall not be less than HK\$3, whichever is higher. In the short term, the disposal may exert downward pressure on Towngas China shares. However, we view this as positive on a long-term basis, given this will increase the free float of the company.

Long-term positive for any potential disposal from EnerChina

Expected decline in financing costs

Currently, the company has an 8.25% guaranteed senior notes to the tune of US\$141mn, which will be due in 2011. Upon maturity of these notes, even if it will be financed by other borrowings, we believe the interest rate for any new financing should be much lower than 8.25%. With current interest expenses for guaranteed senior notes around HK\$90mn, and assuming new financing at 5%, the company can save HK\$36mn related to interest costs, which by our estimates could account for around 6% of the company's earnings in 2012. In addition, the recent interest rate hike in China should not have significant impact on Towngas China, given all its renminbi borrowings are on a fixed-rate terms.

Valuation

PT revised up to HK\$3.4; upgrade from Reduce to NEUTRAL

We have revised our price target to HK\$3.4, which at current price translates to downside potential of 4.5%, and upgrade our rating from Reduce to NEUTRAL, mainly due to valuation. At HK\$3.56, the stock is trading at 18.5x FY11F P/E vs the industry average of 19.6x.

Our new price target of HK\$3.4 is based on DCF valuation, assuming 0% terminal growth, and a WACC of 6.4%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects without a specified commencement date. In addition, we have not factored in any future wellhead price hike, or downstream tariff hike in our assumptions, as we assume any wellhead price hike can be fully passed through to the end-users and a fixed dollar margin can be maintained.

Exhibit 72. Towngas China: DCF valuation

| TOWNGAS CHINA COMPANY LTD. | | | | | | | | | | | |
|---|---------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Discounted Cash Flow Model | | | | | | | | | | | |
| HK\$ mn | 2011F | 2012F | 2013F | 2014F | 2015F | 2016F | 2017F | 2018F | 2019F | 2020F | 2021F |
| Free Cash Flows to the Firm | | | | | | | | | | | |
| Earnings Before Interest and Taxes (EBIT) | 476 | 564 | 647 | 707 | 814 | 922 | 765 | 855 | 955 | 1,065 | 1,124 |
| Taxes on EBIT: | | | | | | | | | | | |
| Add: Income taxes from income statement | 184 | 225 | 261 | 290 | 335 | 380 | 350 | 390 | 433 | 481 | 509 |
| Add: Tax shield on interest expenses | 32 | 30 | 29 | 29 | 31 | 32 | 34 | 35 | 36 | 38 | 39 |
| Less: Tax on Interest Income | (3) | (4) | (5) | (5) | (7) | (9) | (11) | (12) | (14) | (16) | (19) |
| Less: Tax on non-operating income | - | - | - | - | - | - | - | - | - | - | - |
| Total Taxes on EBIT | (214) | (251) | (286) | (314) | (359) | (403) | (373) | (412) | (455) | (503) | (529) |
| Minority Interest | (83) | (102) | (118) | (131) | (151) | (172) | (158) | (176) | (196) | (218) | (230) |
| Change in deferred income taxes | - | - | - | - | - | - | - | - | - | - | - |
| Goodwill Amortization | - | - | - | - | - | - | - | - | - | - | - |
| Dividend from JCE and associates | 115 | 129 | 142 | 155 | 171 | 188 | 197 | 212 | 229 | 248 | 259 |
| Net Operating Profits After Taxes, NOPAT | 294 | 340 | 386 | 417 | 476 | 535 | 430 | 479 | 533 | 593 | 624 |
| Depreciation & Amortization (except goodwill) | 207 | 217 | 225 | 232 | 237 | 242 | 248 | 253 | 258 | 264 | 269 |
| Net Change in Working Capital | 12 | 7 | 7 | 8 | 9 | 9 | 22 | 9 | 10 | 11 | 7 |
| Net Capital Expenditures | (300) | (250) | (200) | (150) | (150) | (150) | (150) | (150) | (150) | (150) | (150) |
| Free Cash Flows to the Firm (FCFF) | 213 | 315 | 418 | 507 | 571 | 636 | 550 | 591 | 652 | 718 | 750 |
| YoY Growth | 48.2% | 32.6% | 21.3% | 12.8% | 11.3% | -13.5% | 7.5% | 10.2% | 10.2% | 4.5% | |
| Key Assumptions | | | | | | | | | | | |
| Risk-free rate | 2.5% | | | | | | | | | | |
| Beta | 0.72 | | | | | | | | | | |
| Market risk premium (rm - rf) | 7.5% | | | | | | | | | | |
| Cost of Equity (re) | 7.9% | | | | | | | | | | |
| Cost of Preferred Equity (rp) | 0.0% | | | | | | | | | | |
| Cost of Debt | 4.7% | | | | | | | | | | |
| Effective Tax Rate | 25.0% | | | | | | | | | | |
| Market Value Preferred Stock/Capital Ratio | 0.0% | | | | | | | | | | |
| Market Value Debt/Capital Ratio | 33.3% | | | | | | | | | | |
| Weight Average Cost of Capital (WACC) | 6.4% | | | | | | | | | | |
| Terminal Growth rate | 0.0% | | | | | | | | | | |
| Discounted Free Cash Flow Valuation | | | | | | | | | | | |
| PV of FCFF during 2011-20 | 3,546 | | | | | | | | | | |
| Continuing value based on CF beyond Year 2020 | 6,253 | | | | | | | | | | |
| Total Enterprise Value (Operating Value) | 9,799 | | | | | | | | | | |
| Add: Excess Cash & Non-operating Investments | 1,231 | | | | | | | | | | |
| Total Firm Value | 11,030 | | | | | | | | | | |
| Equity Valuation | | | | | | | | | | | |
| Total Firm Value | 11,030 | | | | | | | | | | |
| Less: Value of Interest Bearing Debt | 2,842 | | | | | | | | | | |
| Less: Value of Preferred Stock | - | | | | | | | | | | |
| Value of Common Equity | 8,187 | | | | | | | | | | |
| Number of Share Outstanding (mn) | 2,443 | | | | | | | | | | |
| Equity Value per share (HK\$) | 3.35 | | | | | | | | | | |

Sensitivity table 1

---Terminal Growth Rate---

| | 0.00% | 0.25% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% | 1.75% |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|
| 6.00% | 3.68 | 3.82 | 3.96 | 4.12 | 4.29 | 4.48 | 4.69 | 4.93 |
| 6.25% | 3.49 | 3.60 | 3.73 | 3.87 | 4.03 | 4.20 | 4.38 | 4.59 |
| 6.50% | 3.30 | 3.41 | 3.53 | 3.65 | 3.79 | 3.94 | 4.11 | 4.29 |
| 6.75% | 3.13 | 3.23 | 3.34 | 3.45 | 3.57 | 3.71 | 3.86 | 4.02 |
| 7.00% | 2.98 | 3.07 | 3.16 | 3.26 | 3.37 | 3.50 | 3.63 | 3.77 |
| 7.25% | 2.83 | 2.91 | 3.00 | 3.09 | 3.19 | 3.30 | 3.42 | 3.55 |
| 7.50% | 2.70 | 2.77 | 2.85 | 2.93 | 3.03 | 3.12 | 3.23 | 3.35 |
| 7.75% | 2.57 | 2.64 | 2.71 | 2.79 | 2.87 | 2.96 | 3.06 | 3.16 |
| 8.00% | 2.45 | 2.51 | 2.58 | 2.65 | 2.73 | 2.81 | 2.90 | 2.99 |
| 8.25% | 2.34 | 2.40 | 2.46 | 2.52 | 2.59 | 2.67 | 2.75 | 2.83 |
| 8.50% | 2.24 | 2.29 | 2.35 | 2.41 | 2.47 | 2.54 | 2.61 | 2.69 |
| 8.75% | 2.14 | 2.19 | 2.24 | 2.29 | 2.35 | 2.41 | 2.48 | 2.55 |
| 9.00% | 2.05 | 2.09 | 2.14 | 2.19 | 2.24 | 2.30 | 2.36 | 2.43 |
| 9.25% | 1.96 | 2.00 | 2.05 | 2.09 | 2.14 | 2.19 | 2.25 | 2.31 |
| 9.50% | 1.88 | 1.92 | 1.96 | 2.00 | 2.05 | 2.09 | 2.15 | 2.20 |
| 9.75% | 1.80 | 1.84 | 1.87 | 1.91 | 1.96 | 2.00 | 2.05 | 2.10 |
| 10.00% | 1.73 | 1.76 | 1.80 | 1.83 | 1.87 | 1.91 | 1.96 | 2.00 |
| 10.25% | 1.66 | 1.69 | 1.72 | 1.76 | 1.79 | 1.83 | 1.87 | 1.91 |

---WACC---

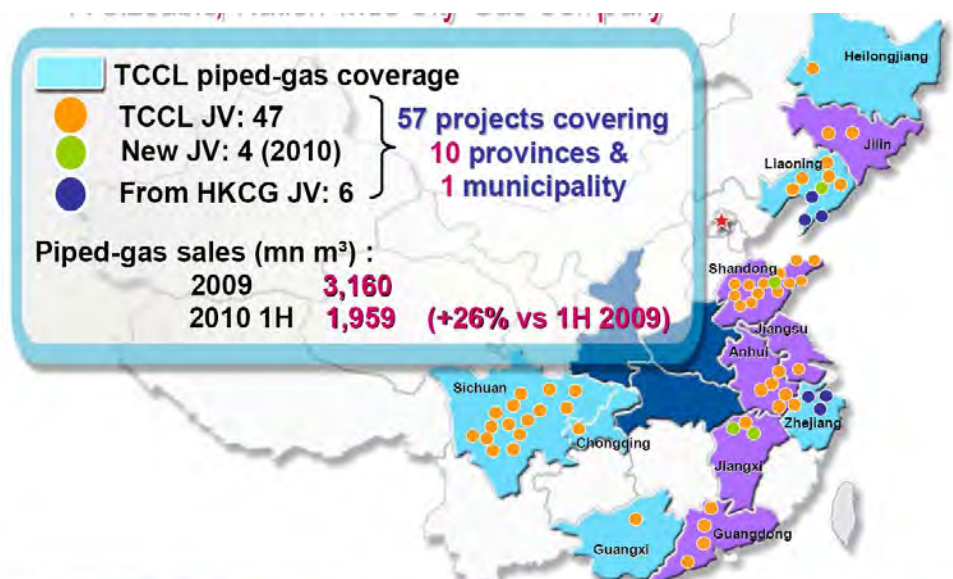
Source: Nomura estimates

Investment risks

Downside risks to our price target include: 1) slower-than-expected new connection and gas sales growth; 2) margin squeeze due to cost pass-through delay; and 3) value-destructive asset injection / acquisition. We believe Towngas China may be slightly affected by the wellhead price hike, given the company has only passed through the increased costs to 40% of the residential customers, with the remaining still under the public hearing process. For C&I, downstream price hike will be implemented retrospectively.

Upside risks include: 1) higher-than-expected gas volume sales to higher margin C&I and vehicle users; and 2) value-constructive asset injection / acquisition.

Exhibit 73. Towngas China: Existing Projects Details



Source: Company data, Nomura research

Exhibit 74. Towngas China: existing projects details

| Project Details | Company Name | Location | Date | Own (%) | Investment | Investment in RMBmn |
|-----------------|---|---|------------|---------|-------------|---------------------|
| Shandong | Qingdao Zhongji Hong Kong and China Gas | Jimo City, Shandong | 24/09/2001 | 90 | RMB174mn | 174 |
| | Qingdao Dongyi Hong Kong and China Gas | Qingdao City, Shandong | 25/03/2002 | 60 | RMB60mn | 60 |
| | Longkou Hong Kong and China Gas | Longkou City, Shandong | 18/11/2002 | 100 | RMB84mn | 84 |
| | Zibo Hong Kong and China Gas | Zibo City, Shandong | 26/08/2002 | 50 | RMB140mn | 140 |
| | Zibo Lubo Gas Company Ltd. | Zibo City, Shandong | 27/02/2004 | 27 | RMB100mn | 100 |
| | Weifang Hong Kong and China Gas | Weifang City, Shandong | 6/11/2003 | 50 | RMB240mn | 240 |
| | Weihai Hong Kong and China Gas | Weihai City, Shandong | 23/12/2003 | 50 | RMB245mn | 245 |
| | Taian Taishan Hong Kong and China Gas | Taian City, Shandong | 18/02/2004 | 50 | RMB200mn | 200 |
| | Jinan Jihua Gas | Jinan City, Shandong | 27/02/2004 | 51 | RMB220mn | 220 |
| | Shandong Jihua Gas | Jinan City West, Shandong | 3/11/2005 | 48 | RMB405mn | 405 |
| | Chiping Hong Kong & China Gas | Chiping County, Liaocheng City, Shandong | 10/3/2009 | 85 | RMB60mn | 60 |
| | Linqu Hong Kong & China Gas | Linqu County, Weifang City, Shandong | 2/12/2009 | 25 | RMB80mn | 80 |
| Jiangsu | Gaochun Hong Kong and China Gas | Gaochun County, Nanjing City, Jiangsu | 18/04/2002 | 100 | RMB12mn | 12 |
| Anhui | Maanshan Hong Kong and China Gas | Maanshan City, Anhui | 5/6/2003 | 50 | RMB248mn | 248 |
| | Anqing Hong Kong and China Gas | Anqing City, Anhui | 23/11/2004 | 50 | RMB182mn | 182 |
| | Chizhou Hong Kong & China Gas | Chizhou City, Anhui | 1/9/2003 | 100 | RMB40mn | 40 |
| | Huangshan Hong Kong & China Gas | Huangshan City, Anhui | 9/5/2008 | 100 | RMB70mn | 70 |
| | Huangshan Huizhou Hong Kong & China Gas | Huizhou District, Huangshan City, Anhui | 27/11/2009 | 100 | RMB29mn | 29 |
| | Huangshan Taiping Hong Kong & China Gas | Huangshan District, Huangshan City, Anhui | 9/10/2009 | 100 | RMB70mn | 70 |
| Liaoning | Benxi Hong Kong and China Gas | Benxi City, Liaoning | 30/11/2005 | 80 | RMB150mn | 150 |
| | Tieling Hong Kong and China Gas | Tieling City, Liaoning | 13/12/2005 | 80 | RMB95mn | 95 |
| | Chaoyang Hong Kong and China Gas | Chaoyang City, Liaoning | 21/12/2005 | 90 | RMB200mn | 200 |
| | Fuxin Hong Kong and China Gas | Fuxin City, Liaoning | 13/07/2006 | 90 | RMB180mn | 180 |
| | Shengyang Hong Kong and China Gas | Jinhan Economic Zone, Shenyang City, Liaoning | 14/10/2008 | 100 | RMB136mn | 136 |
| | Yingkou Hong Kong and China Gas | Yingkou City, Liaoning | 29/09/2006 | 100 | USD18.8mn | 128 |
| | Dalian Changxing Hong Kong and China Gas | Changxing, Dalian City, Liaoning | 23/09/2008 | 100 | USD25mn | 170 |
| | Dalian DETA Hong Kong and China Gas | Changxing, Dalian City, Liaoning | 12/12/2008 | 40 | RMB329.28mn | 329 |
| | An Shan Hong Kong and China Gas | New Industrial District of Anshan City, Liaoning | 4/3/2008 | 100 | RMB140mn | 140 |
| | Dalian Lvshun Hong Kong and China Gas | Dalian Lvshun Economic Development Zone, Liaoning | 11/6/2010 | 100 | RMB210mn | 210 |
| Jilin | Changchun Gas Holding Limited | Changchun City, Jilin | 1/2/2005 | 48 | RMB800mn | 800 |
| | Gongzhuling Hong Kong and China Gas | Gongzhuling City, Jilin | 29/12/2007 | 100 | RMB90mn | 90 |
| Heilong Jiang | Qiqihaer Hong Kong and China Gas | Qiqihaer City, Heilongjiang | 29/01/2005 | 62 | RMB148mn | 148 |
| Guangdong | Qingyuan Hong Kong and China Gas | Qingyuan City, Guangdong | 16/03/2006 | 80 | RMB20mn | 20 |
| | Shaoguan Hong Kong and China Gas | Shaoguan City, Guangdong | 16/03/2006 | 100 | RMB18mn | 18 |
| | Foshan Gas Group | Foshan City, Guangdong | 3/11/2004 | 43 | RMB400mn | 400 |
| | GUANGDONG - Yangjiang Hong Kong and China Gas | Yangjiang City, Guangdong | 10/11/2009 | 100 | RMB100mn | 100 |
| Sichuan | Ziyang Hong Kong and China Gas | Ziyang City, Sichuan | 16/07/2002 | 90 | RMB19mn | 19 |
| | Weiyuan Hong Kong and China Gas | Weiyuan County, Sichuan | 25/12/2002 | 100 | RMB23mn | 23 |
| | Pengxi Hong Kong and China Gas | Pengxi County, Sichuan | 14/05/2003 | 90 | RMB13mn | 13 |
| | Lezhi Hong Kong and China Gas | Lezhi County, Sichuan | 22/12/2003 | 100 | RMB10mn | 10 |
| | Pingchang Hong Kong and China Gas | Pingchang County, Sichuan | 8/5/2004 | 90 | RMB14mn | 14 |
| | Dayi Hong Kong and China Gas | Dayi County, Sichuan | 8/6/2004 | 100 | RMB10mn | 10 |
| | Yuechi Hong Kong and China Gas | Yuechi County, Sichuan | 3/8/2004 | 90 | RMB15mn | 15 |
| | Cangxi Hong Kong and China Gas | Cangxi County, Sichuan | 27/10/2004 | 100 | RMB10mn | 10 |
| | Zhongjiang Hong Kong and China Gas | Zhongjiang, Sichuan | 29/03/2005 | 100 | RMB22mn | 22 |
| | Jianyang Hong Kong and China Gas | Jianyang, Sichuan | 31/03/2005 | 100 | RMB29mn | 29 |
| | Pengshan Hong Kong and China Gas | Pengshan, Sichuan | 1/6/2005 | 70 | RMB12mn | 12 |
| | Chengdu City Gas Co., Ltd. | Chengdu, Sichuan | 16/03/2005 | 13 | RMB800mn | 800 |
| | Mianyang Hong Kong & China Gas | Mianyang City, Sichuan | 22/01/2008 | 100 | RMB200mn | 200 |
| | Xinjin Nanfang Natural Gas | Xinjin County, Sichuan | 26/03/2009 | 60 | RMB100mn | 100 |
| | Xin Du Hong Kong and China Gas, Cheng Du | Xindu District, Chengdu City, Sichuan | 1/4/2009 | 100 | RMB253mn | 253 |
| Chongqing | Chongqing Hong Kong and China Gas | Qijiang County, Chongqing Municipality | 30/04/2008 | 50 | RMB60mn | 60 |
| Jiangxi | Jiangxi Jihua Energy Development | Jiujiang City, Jiangxi | 3/12/2009 | 60 | RMB210mn | 210 |
| Zhejiang | Hangzhou Hong Kong and China Gas | Hangzhou City, Zhejiang | 27/03/2006 | 50 | USD29.98mn | 204 |
| | Tongxiang Hong Kong and China Gas | Tongxiang City, Zhejiang | 14/03/2003 | 76 | RMB83mn | 83 |
| | Huzhou Hong Kong and China Gas | Huzhou City, Zhejiang | 16/11/2004 | 99 | RMB200mn | 200 |
| Guangxi | Guilin Hong Kong and China Gas | Lingui New District, Guilin City, Guangxi | 1/7/2010 | 95 | RMB74mn | 74 |
| Total | 57 | | | | | 8,334 |

Source: Company data, Nomura research

Financial statements

| Income statement (HK\$mn) | | | | | |
|---------------------------------------|------------|------------|------------|--------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Revenue | 4,409 | 2,025 | 2,749 | 3,530 | 4,109 |
| Cost of goods sold | (3,541) | (1,343) | (1,925) | (2,514) | (2,934) |
| Gross profit | 868 | 682 | 824 | 1,016 | 1,175 |
| SG&A | (592) | (397) | (446) | (539) | (610) |
| Employee share expense | - | - | - | - | - |
| Operating profit | 276 | 285 | 378 | 476 | 564 |
| EBITDA | 453 | 458 | 574 | 684 | 782 |
| Depreciation | (159) | (169) | (180) | (191) | (201) |
| Amortisation | (18) | (4) | (17) | (16) | (16) |
| EBIT | 276 | 285 | 378 | 476 | 564 |
| Net interest expense | (128) | (104) | (111) | (106) | (93) |
| Associates & JCEs | 208 | 211 | 286 | 367 | 428 |
| Other income | 5 | 2 | - | - | - |
| Earnings before tax | 361 | 394 | 553 | 738 | 900 |
| Income tax | (90) | (92) | (138) | (184) | (225) |
| Net profit after tax | 271 | 302 | 415 | 553 | 675 |
| Minority interests | (69) | (47) | (62) | (83) | (102) |
| Other items | - | 10 | - | - | - |
| Preferred dividends | - | - | - | - | - |
| Normalised NPAT | 202 | 265 | 352 | 470 | 573 |
| Extraordinary items | - | - | - | - | - |
| Reported NPAT | 202 | 265 | 352 | 470 | 573 |
| Dividends | (20) | (39) | (70) | (94) | (115) |
| Transfer to reserves | 183 | 226 | 282 | 376 | 458 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 34.5 | 26.3 | 22.6 | 18.8 | 15.4 |
| FD normalised P/E at price target (x) | 33.0 | 25.1 | 21.6 | 18.0 | 14.7 |
| Reported P/E (x) | 34.5 | 26.3 | 22.3 | 18.5 | 15.2 |
| Dividend yield (%) | 0.3 | 0.6 | 0.8 | 1.1 | 1.3 |
| Price/cashflow (x) | 12.5 | 12.0 | 17.4 | 17.0 | 15.4 |
| Price/book (x) | 1.1 | 1.1 | 1.0 | 1.0 | 0.9 |
| EV/EBITDA (x) | 15.3 | 15.7 | 12.1 | 9.8 | 8.3 |
| EV/EBIT (x) | 20.9 | 21.2 | 15.7 | 12.2 | 10.2 |
| Gross margin (%) | 19.7 | 33.7 | 30.0 | 28.8 | 28.6 |
| EBITDA margin (%) | 10.3 | 22.6 | 20.9 | 19.4 | 19.0 |
| EBIT margin (%) | 6.3 | 14.1 | 13.8 | 13.5 | 13.7 |
| Net margin (%) | 4.6 | 13.1 | 12.8 | 13.3 | 13.9 |
| Effective tax rate (%) | 24.9 | 23.3 | 25.0 | 25.0 | 25.0 |
| Dividend payout (%) | 9.7 | 14.8 | 20.0 | 20.0 | 20.0 |
| Capex to sales (%) | 13.8 | 26.1 | 10.9 | 8.5 | 6.1 |
| Capex to depreciation (x) | 3.8 | 3.1 | 1.7 | 1.6 | 1.2 |
| ROE (%) | 3.1 | 3.8 | 4.4 | 5.1 | 5.9 |
| ROA (pretax %) | 5.4 | 5.0 | 5.8 | 6.7 | 7.6 |
| Growth (%) | | | | | |
| Revenue | 38.0 | (54.1) | 35.7 | 28.4 | 16.4 |
| EBITDA | 17.5 | 1.1 | 25.4 | 19.0 | 14.3 |
| EBIT | 16.1 | 3.2 | 32.6 | 26.0 | 18.5 |
| Normalised EPS | 23.6 | 31.0 | 18.2 | 20.2 | 21.9 |
| Normalised FDEPS | 24.3 | 31.1 | 16.3 | 20.4 | 21.9 |
| Per share | | | | | |
| Reported EPS (HK\$) | 0.10 | 0.14 | 0.16 | 0.19 | 0.23 |
| Norm EPS (HK\$) | 0.10 | 0.14 | 0.16 | 0.19 | 0.23 |
| Fully diluted norm EPS (HK\$) | 0.10 | 0.14 | 0.16 | 0.19 | 0.23 |
| Book value per share (HK\$) | 3.16 | 3.29 | 3.45 | 3.61 | 3.79 |
| DPS (HK\$) | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 |

Source: Nomura estimates

| Cashflow (HK\$mn) | | | | | |
|--------------------------------------|--------------|--------------|--------------|------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| EBITDA | 453 | 458 | 574 | 684 | 782 |
| Change in working capital | 245 | 577 | 14 | 12 | 7 |
| Other operating cashflow | (143) | (451) | (138) | (185) | (225) |
| Cashflow from operations | 556 | 583 | 450 | 511 | 564 |
| Capital expenditure | (610) | (528) | (300) | (300) | (250) |
| Free cashflow | (54) | 55 | 150 | 211 | 314 |
| Reduction in investments | 1 | 1 | - | - | - |
| Net acquisitions | | | | | |
| Reduction in other LT assets | (21) | (467) | (793) | (245) | (291) |
| Addition in other LT liabilities | 10 | 26 | - | - | - |
| Adjustments | (79) | 131 | 913 | 383 | 448 |
| Cashflow after investing acts | (142) | (253) | 270 | 349 | 471 |
| Cash dividends | (10) | (37) | (70) | (94) | (115) |
| Equity issue | 3 | 2 | - | - | - |
| Debt issue | 289 | 492 | (148) | 225 | (13) |
| Convertible debt issue | | | | | |
| Others | (63) | (104) | (136) | (130) | (120) |
| Cashflow from financial acts | 219 | 353 | (354) | 2 | (248) |
| Net cashflow | 77 | 100 | (84) | 351 | 223 |
| Beginning cash | 787 | 864 | 964 | 880 | 1,231 |
| Ending cash | 864 | 964 | 880 | 1,231 | 1,454 |
| Ending net debt | 1,400 | 1,801 | 1,737 | 1,611 | 1,376 |

Source: Nomura estimates

| Balance sheet (HK\$mn) | | | | | |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| As at 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Cash & equivalents | 864 | 964 | 880 | 1,231 | 1,454 |
| Marketable securities | | | | | |
| Accounts receivable | 102 | 98 | 133 | 171 | 199 |
| Inventories | 193 | 102 | 146 | 191 | 223 |
| Other current assets | 453 | 412 | 411 | 411 | 411 |
| Total current assets | 1,611 | 1,575 | 1,570 | 2,003 | 2,286 |
| LT investments | 170 | 169 | 169 | 169 | 169 |
| Fixed assets | 3,811 | 4,077 | 4,197 | 4,306 | 4,355 |
| Goodwill | 2,492 | 2,753 | 3,864 | 3,864 | 3,864 |
| Other intangible assets | 195 | 182 | 174 | 166 | 157 |
| Other LT assets | 2,107 | 2,574 | 3,367 | 3,612 | 3,903 |
| Total assets | 10,387 | 11,330 | 13,342 | 14,120 | 14,734 |
| Short-term debt | 223 | 562 | 264 | 339 | 395 |
| Accounts payable | 199 | 215 | 308 | 402 | 469 |
| Other current liabilities | 950 | 1,376 | 1,376 | 1,376 | 1,376 |
| Total current liabilities | 1,372 | 2,153 | 1,948 | 2,118 | 2,241 |
| Long-term debt | 2,041 | 2,203 | 2,353 | 2,503 | 2,434 |
| Convertible debt | | | | | |
| Other LT liabilities | 60 | 87 | 87 | 87 | 87 |
| Total liabilities | 3,474 | 4,442 | 4,388 | 4,707 | 4,761 |
| Minority interest | 735 | 455 | 517 | 600 | 702 |
| Preferred stock | | | | | |
| Common stock | 196 | 196 | 244 | 244 | 244 |
| Retained earnings | 5,962 | 6,199 | 8,122 | 8,475 | 8,912 |
| Proposed dividends | 20 | 39 | 70 | 94 | 115 |
| Other equity and reserves | | | | | |
| Total shareholders' equity | 6,178 | 6,434 | 8,437 | 8,813 | 9,271 |
| Total equity & liabilities | 10,387 | 11,330 | 13,342 | 14,120 | 14,734 |

Liquidity (x)

| | | | | | |
|----------------|------|------|------|------|------|
| Current ratio | 1.17 | 0.73 | 0.81 | 0.95 | 1.02 |
| Interest cover | 2.2 | 2.7 | 3.4 | 4.5 | 6.1 |

Leverage

| | | | | | |
|---------------------|------|------|------|------|------|
| Net debt/EBITDA (x) | 3.09 | 3.93 | 3.02 | 2.36 | 1.76 |
| Net debt/equity (%) | 22.7 | 28.0 | 20.6 | 18.3 | 14.8 |

Activity (days)

| | | | | | |
|-----------------|------|------|--------|--------|--------|
| Days receivable | 8.1 | 18.0 | 15.4 | 15.7 | 16.5 |
| Days inventory | 17.8 | 40.0 | 23.5 | 24.4 | 25.8 |
| Days payable | 18.1 | 56.3 | 49.5 | 51.5 | 54.3 |
| Cash cycle | 7.8 | 1.8 | (10.7) | (11.3) | (12.1) |

Source: Nomura estimates

Action

We believe: 1) the LPG business continues to drag down overall profitability and raises the risk profile of the company, 2) limited growth potential from small cities and 3) option dilution and interest rate hike sensitivity also limit shareholders' returns. With weak fundamentals ahead, we downgrade China Gas to REDUCE, with a new price target of HK\$3.70, representing potential downside of 16%.

Catalysts

Any LPG cost hikes would act as catalysts for our REDUCE rating.

Anchor themes

We are upbeat on China's gas distribution sector, considering: 1) favourable government policies, 2) robust demand growth underpinned by the transition to clean and low-cost energy, 3) stable margins attributable to strong cost pass-through capability and 4) potential upside from new energy initiatives.

Weighed down by LPG business; downgrade to REDUCE

1 Bearish view on LPG business

Despite the ambitious management target of a 23% gross profit margin for the LPG business by 2015F, we maintain our bearish view, due to: 1) keen competition from the LPG retail business; 2) phase-out risk of LPG from the threat of piped gas supply and 3) uncontrollable upstream costs.

2 Limited growth potential for its small city gas projects

We see lower upside growth potential for its piped gas business projects. Although the company has the most projects across our gas coverage universe, the project size is generally small city piped gas projects, which offer limited growth potential in the long term.

3 16.2% EPS dilution impact from share options

The 842.4mn share options outstanding, with exercise price prices of HK\$0.71-HK\$2.6, are all in the money. The options in total represent 19.3% of total outstanding shares, with potential EPS dilution of 16.2%.

4 Material impact from rising interest rates

Despite the recent share issuance to reduce RMB debt, the company remains sensitive to interest rate hikes. We estimate that for every 1% interest rate hike, the company's FY11F net profit would be dragged down by 11% – the highest in the sector.

5 Demanding valuation; downgrade to REDUCE

At HK\$4.42, the company is trading at 22.8x FY11F basic EPS and 30.8x FY11F fully diluted EPS. Given its weak fundamentals with low margin and high gearing, valuation looks demanding. We downgrade China Gas to REDUCE with a revised PT of HK\$3.70.

| | |
|---------------------------|------------------------------------|
| Closing price on 2 Nov | HK\$4.42 |
| Price target | HK\$3.70 (from HK\$4.30) |
| Upside/downside | -16.3% |
| Difference from consensus | -22.9% |
| FY11 net profit (HK\$m) | 747 |
| Difference from consensus | na |
| Source: Nomura | |

Nomura vs consensus

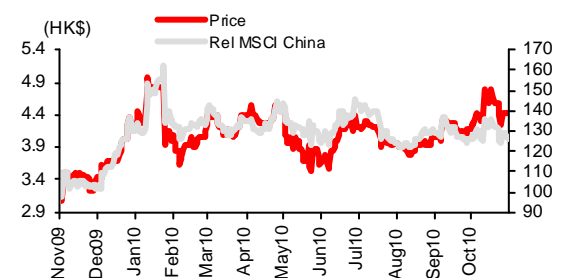
We are bearish on the prospects of the LPG business and concerned about the financing burden for the company amid a rising interest rate environment.

Key financials & valuations

| 31 Mar (HK\$m) | FY09 | FY10 | FY11 | FY12F |
|---------------------------|--------|--------|--------|--------|
| Revenue | 6,324 | 10,212 | 14,741 | 18,747 |
| Reported net profit | 104 | 876 | 747 | 1,010 |
| Normalised net profit | 104 | 876 | 747 | 1,010 |
| Normalised EPS (HK\$) | 0.03 | 0.26 | 0.19 | 0.23 |
| Norm. EPS growth (%) | (29.2) | 741.9 | (26.0) | 19.7 |
| Norm. P/E (x) | 150.8 | 21.7 | 30.8 | 22.8 |
| EV/EBITDA (x) | 22.8 | 15.6 | 10.1 | 7.9 |
| Price/book (x) | 4.6 | 3.6 | 2.4 | 2.2 |
| Dividend yield (%) | 0.3 | 0.3 | 0.4 | 0.5 |
| ROE (%) | 3.3 | 23.8 | 12.3 | 12.0 |
| Net debt/equity (%) | 256.4 | 229.1 | 69.2 | 50.5 |
| Earnings revisions | | | | |
| Previous norm. net profit | | 476 | 822 | 1,092 |
| Change from previous (%) | | 84.0 | (9.1) | (7.5) |
| Previous norm. EPS (HK\$) | | 0.14 | 0.22 | 0.29 |

Source: Company, Nomura estimates

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|-------|------|-----------|
| Absolute (HK\$) | 6.0 | 11.6 | (0.9) |
| Absolute (US\$) | 6.1 | 11.8 | (0.7) |
| Relative to Index | (0.3) | 1.7 | (11.3) |
| Market cap (US\$m) | | | 2,075 |
| Estimated free float (%) | | | 0.6 |
| 52-week range (HK\$) | | | 4.99/3.09 |
| 3-mth avg daily turnover (US\$m) | | | 12.44 |
| Stock borrowability | | | Hard |
| Major shareholders (%) | | | |
| Liu Ming Hui | | | 16.1 |
| Chey Tae won | | | 11.7 |

Source: Company, Nomura estimates

Investment Concern

Weak fundamentals; highest risk profile

We downgrade China Gas to REDUCE, as the company possesses the weakest fundamentals across our gas distribution coverage space, with the lowest margin mainly caused by the LPG business, and limited growth potential from its smaller size piped gas projects. Despite management's aggressive plan to turn around the slim margin LPG business by having vertical integration, we maintain our bearish view. In addition, the share options will bring a 16.2% dilution impact to the company in total. We downgrade the company to REDUCE with a revised price target of HK\$3.70.

LPG: volatile business with thin margin

In 2008, the company acquired the LPG business, and set an ambitious target to increase the gross profit margin from 5.7% in FY09 to 23% in FY15F by vertical integration. Although the FY10 margin recorded a 3pps increase to 8.7%, we believe the thin margin business is more likely to persist due to the uncontrollable costs at refineries (i.e. supply side risks) and fierce competition in the downstream segment.

More volatile in LPG cost than downstream selling price

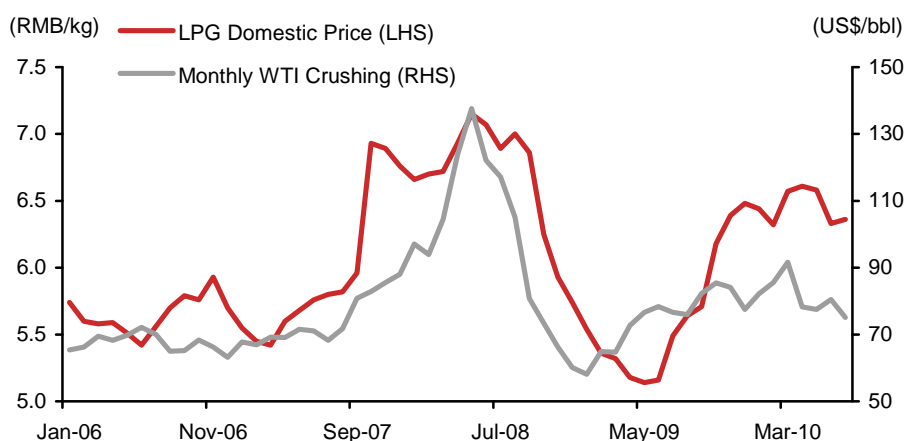
China Gas has noted that whenever there is any imported upstream costs increase, the company is either able to switch from imports to local refineries to avoid higher costs, or to pass through the higher costs to end users.

However, we see difficulties in terms of fully performing supply switching, given that:

1) oil refinery giants such as Sinopec and CNPC are in control of the LPG source and
2) domestic LPG prices are converging with international prices. In addition, as shown in the charts below, the correlation between LPG end-user price and crude oil price is only 0.76, implying a lag between cost and price changes for the LPG business.

As an example, in FY10, the company sold 944,000 tons of LPG, which was lower than its previous guidance of 1.2-1.3mn tons. We expect one of the major reason was the significant increase in imported LPG price in Sep 09 to Mar 10 (up 43.4%) resulting in a fewer purchases. This issue not only demonstrates the difficulties in retaining control over upstream vendors on pricing, but also on the high LPG price volatility.

Exhibit 75. Price: LPG end users vs WTI crushing



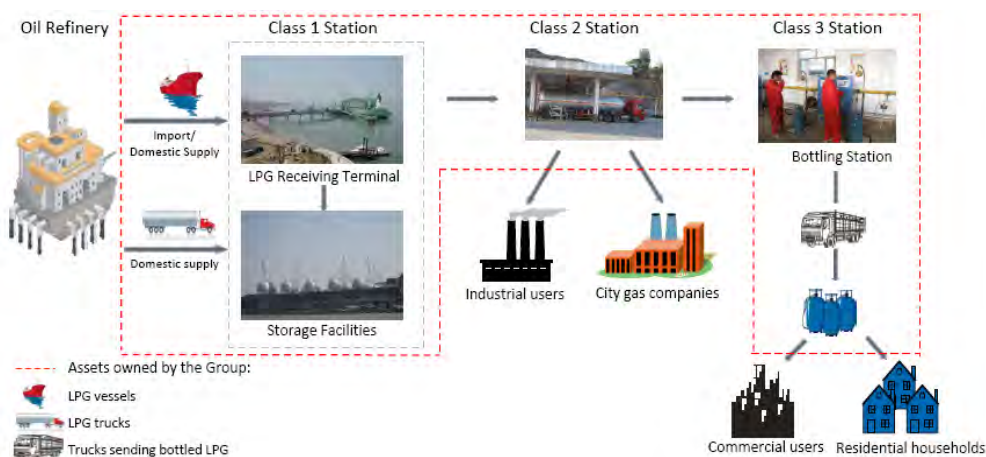
Source: Bloomberg, Nomura research

Vertical integration works but takes time

In order to achieve higher profit margin, the company intended to adopt a vertical integration approach such that the company targets to earn 23% gross margin by FY15F, with 5-6% margin from sourcing LPG and transporting to Class 1 Stations, 6-7% from transporting to Class 2 and 3 stations, and 10-12% from retailers. We believe the vertical integration approach can enhance the return on LPG business, but we see the impact to be insignificant and continue to maintain our bearish view, given: 1) keen competition from the LPG retailing business, with >10,000 small LPG bottling operators in China due to the low entry barriers (~RMB1mn to acquire a small bottling operator) and these small operators are satisfied with single digit margins; 2) with more natural gas supply in the coming years and more gas pipeline to be constructed, LPG will face the phase-out risks; and 3) the uncontrollable upstream price provide margin volatility to the business. We estimate the company will enjoy gross profit margin of around 10% for the LPG business, bringing the company's overall gross profit margin of 19-21%, versus the industry peers of 22-30%.

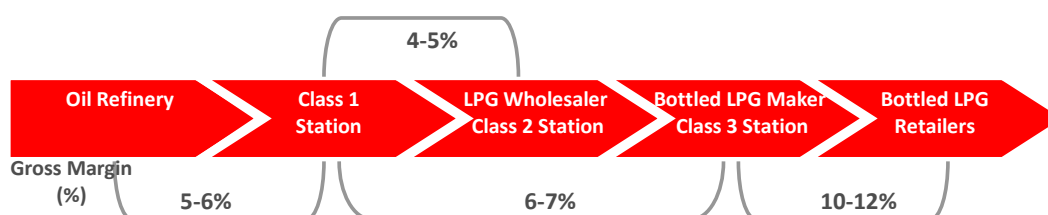
Vertical integration can enhance the margin, but cannot provide full margin protection

Exhibit 76. China Gas: potential vertical integration

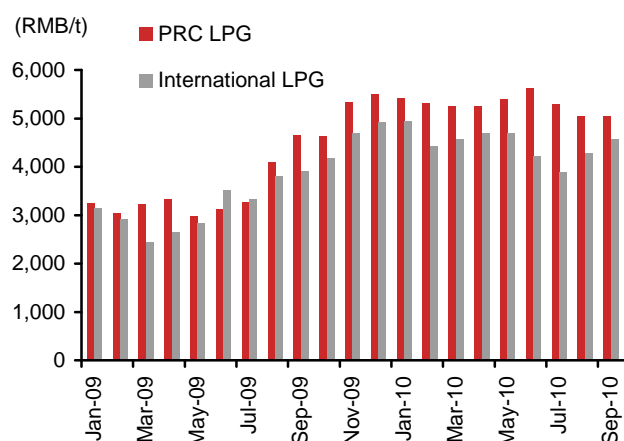


Source: Company data, Nomura research

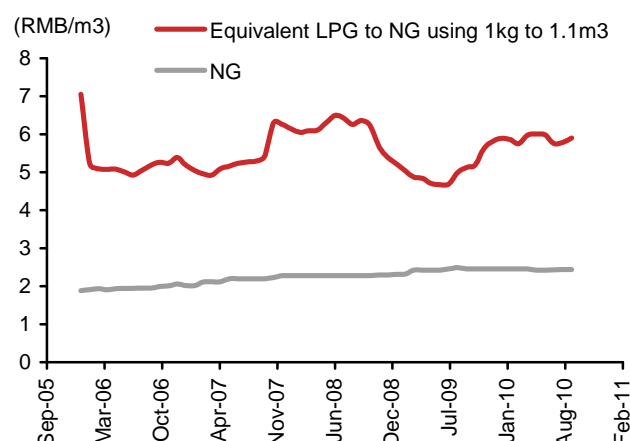
Exhibit 77. China Gas: target gross margin in LPG value chain



Source: Company data, Nomura research

Exhibit 78. Per capita energy consumption NG vs LPG consumption

Source: CEIC, Nomura research

Exhibit 79. LPG vs NG price (using 1 kg LPG to 1.1 m3 NG conversion)

Source: CEIC, Nomura research

Piped gas business – limited growth potential

Although the company has the largest amount of projects out of our covered gas distributors, i.e. with 134 projects, we see the lowest organic growth potential for its piped gas business projects. We see the relatively lower growth potential for its piped gas business projects on a longer term basis, since the projects are generally those small city piped gas projects.

Delay for wellhead price hikes pass through

For C&I customers, same as other players, the company has already passed through the increased gas costs to the C&I customers, at the magnitude of around RMB0.35-0.4/m3 and applied retrospectively, i.e. starting from 1 Jun 2010. However, for residential users, the company is still in the process of public hearing for the pass through and only 34 out of 99 operating projects have been done as of today. The company expected to have the public hearing for the rest of the projects by Oct and Nov. We believe the delay may result in short-term margin squeeze for the company.

Potential 16.2% EPS dilution from share options

China Gas currently has 842.4mn share options outstanding, of which all are in the money (exercise prices ranged from HK\$0.71 to HK\$2.60 per share vs the current share price of HK\$4.42). Out of this 842.4mn share options, 440.5mn are exercisable now. In addition, there is a large tranche of 300mn with strike price of HK\$2.10 which will only be exercisable when China Gas's profit after tax is more than HK\$1.5bn. Overall, the share options represented a 19.3% of total outstanding shares, with potential EPS dilution of 16.2%.

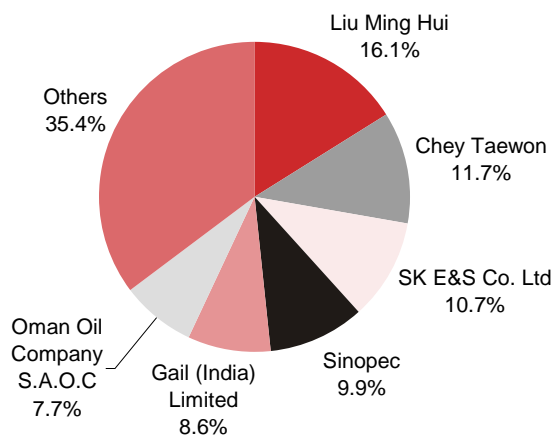
The large amount of outstanding options provides a hurdle to the share price performance. For our PT, we have assumed all the shares options have been exercised, resulting in larger number of outstanding shares but at a higher cash balance, which is resulting from the options exercise.

Options equal to 19.3% of total shares, potential EPS dilution could be 16.2%

Exhibit 80. CG: Share options outstanding and exercised to date

| CHINA GAS | | | | | | | | | | | | |
|--|------------------------------------|-------------------------|---|-------------|-------------------------|-------------------------|-------------------------|---------------------------|---------------------------|---------------------------|--------|--|
| Exercise Price (HK\$) | | | | | | | | | | | | |
| | 0.71 | 0.80 | 1.50 | 1.52 | 1.77 | 2.10 | 2.32 | 2.60 | 2.60 | Total | | |
| Outstanding at 31 March 2010 (mn) | 311.70 | 63.82 | 156.80 | 6.50 | 3.00 | 300.00 | 90.39 | 3.00 | 5.00 | 5.00 | 945 | |
| Exercisable period | 22 Nov 2004 - 5 Oct 2014 | 1 Sep 2004 - 8 Jan 2014 | 20 Oct 2010 - 27 Jan 2011 - 19 Oct 2015 | 26 Jan 2016 | 3 Sep 2009 - 6 Aug 2018 | 3 Aug 2009 - 2 Aug 2019 | 3 Aug 2011 - 2 Aug 2014 | 19 Sep 2008 - 22 Aug 2017 | 14 Oct 2009 - 16 Sep 2014 | 17 Sep 2012 - 16 Sep 2014 | | |
| Date Exercised since 31 March 2010 | Total No. of shares exercised (mn) | | | | | | | | | | | |
| 20 October 2010 | 1.10 | 1.10 | | | | | | | | | | |
| 18 October 2010 | 0.75 | | | | | | | | 0.75 | | | |
| 14 October 2010 | 2.00 | | | | | | | | 2.00 | | | |
| 30 September 2010 | 0.37 | 0.37 | | | | | | | | | | |
| 17 September 2010 | 11.94 | 6.00 | 5.94 | | | | | | | | | |
| 15 September 2010 | 0.75 | | | | | | | | 0.75 | | | |
| 13 September 2010 | 21.00 | 12.00 | 9.00 | | | | | | | | | |
| 03 September 2010 | 3.00 | | | | 3.00 | | | | | | | |
| 25 August 2010 | 3.00 | 3.00 | | | | | | | | | | |
| 23 August 2010 | 2.70 | 0.70 | 2.00 | | | | | | | | | |
| 29 July 2010 | 4.00 | 4.00 | | | | | | | | | | |
| 20 July 2010 | 32.00 | 27.00 | 5.00 | | | | | | | | | |
| 09 July 2010 | 12.00 | 8.00 | 4.00 | | | | | | | | | |
| 08 July 2010 | 2.80 | | 2.80 | | | | | | | | | |
| 21 June 2010 | 4.10 | 4.10 | | | | | | | | | | |
| 04 June 2010 | 0.90 | 0.90 | | | | | | | | | | |
| 05 May 2010 | 0.40 | 0.40 | | | | | | | | | | |
| Total exercised | 102.81 | 57.70 | 38.61 | - | 3.00 | - | - | - | 3.50 | - | | |
| Total exercised (HK\$ mn) | 86.27 | 40.97 | 30.89 | - | 5.31 | - | - | - | 9.10 | - | | |
| Total current outstanding (mn) | 254.00 | 25.21 | 156.80 | 6.50 | - | 300.00 | 90.39 | 3.00 | 1.50 | 5.00 | 842.40 | |
| Total current outstanding - Exercisable (mn) | 254.00 | 25.21 | 156.80 | | - | | | 3.00 | 1.50 | | 440.51 | |
| As % of total outstanding shares: | 19.3% | | | | | | | | | | | |
| Potential EPS Dilution: | -16.2% | | | | | | | | | | | |
| Source: HKEX | | | | | | | | | | | | |
| Total current outstanding (mn) | 254.00 | 25.21 | 156.80 | 6.50 | - | 300.00 | 90.39 | 3.00 | 1.50 | 5.00 | 842 | |
| Exercise price (HK\$) | 0.71 | 0.80 | 1.50 | 1.52 | 1.77 | 2.10 | 2.10 | 2.32 | 2.60 | 2.60 | | |
| Cash received upon exercise (HK\$ mn) | 180 | 20 | 235 | 10 | - | 630 | 190 | 7 | 4 | 13 | 1,289 | |
| Source: HKEX, Nomura Estimates | | | | | | | | | | | | |

Exhibit 81. China Gas: Current shareholding



Source: HKEX, Nomura research

Large future capex; share placement to reduce high gearing

With the aggressive acquisition plan in the past few years, the company's debt/equity ratio has risen sharply, from 72.9% in 2007 to 229.1% in 2010. We expect the company will continue to incur significant capex in the coming years, given: 1) its intention to expand in the LPG downstream business for the vertical integration; and 2) the growth in the piped gas business and the newly acquired Zhongyu Gas (another low margin business waiting to be turned around) also have substantial capex needs.

As a result of the high gearing and potential RMB appreciation, on 26 Oct 2010, the company placed 718.6mn shares and raised gross proceeds of HK\$3,097mn (net proceeds of HK\$3,070mn). The proceeds will be used to reduce the debt of the company (the RMB debt borrowings).

Despite the recent share placement to reduce debt, the company is still the most sensitive to interest rate hike. As shown in the table above, the company has the lowest EBITDA interest coverage ratio, at 4.1x, versus the industry peers from 5.3-22.9x. With the rising interest rate environment, we expect China Gas to be negatively impacted the most across the sector. Based on our sensitivity analysis, for 1% interest rate hike, the company's FY11F net profit will be reduced significantly by 11%.

Exhibit 82. China Gas: Interest Rate Sensitivity Analysis

| Company | FY11 Net Gearing (%) | FY11 Effective Interest Rate (%) | FY11 Interest Coverage Ratio | 1% Interest Hike Impact on EPS |
|---------------|----------------------|----------------------------------|------------------------------|--------------------------------|
| CR Gas | cash | 2.5% | na | 2.0% |
| BJE | 3.5% | 4.7% | 6.27 | 2.6% |
| ENN Energy | 29.0% | 6.5% | 5.39 | 2.4% |
| Towngas China | 17.1% | 4.7% | 5.28 | 3.7% |
| China Gas | 69.2% | 4.5% | 3.27 | 11.0% |

Source: Nomura estimates

Valuation

Valuation demanding; downgrade to REDUCE

We have revised our PT to HK\$3.70, with downside potential of 16.3% and downgrade our rating from Neutral to REDUCE. At HK\$4.42, China Gas is trading at 22.8x FY11F basic EPS and 30.8x FY11F fully diluted EPS, versus an industry average of 19.6x. Valuation looks demanding, given its risk profile, lower margins but higher gearing.

Our price target of HK\$3.70 is based on DCF valuation, assuming 0% terminal growth, and a WACC of 7.6%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects without specified commencement date. In addition, we have not factored in any future wellhead price hike, or downstream tariff hike in our assumptions, as we assume any wellhead price hike can be fully passed through to the end users and a fixed dollar margin can be maintained. Given the “in-the-money” share options possessed by the company, we assumed all the share options have been exercised.

Exhibit 83. China Gas: DCF Valuation

| CHINA GAS HOLDINGS | | | | | | | | | | | | | |
|---|---------|---------|-------|-------|-------|-------|--------|-------|-------|-------|-------|-------|-------|
| Discounted Cash Flow Model | | | | | | | | | | | | | |
| HK\$ mn | 2011F | 2012F | 2013F | 2014F | 2015F | 2016F | 2017F | 2018F | 2019F | 2020F | 2021F | 2022F | 2023F |
| Free Cash Flow to the Firm | | | | | | | | | | | | | |
| Earnings Before Interest & Taxes (EBIT) | 1,507 | 1,910 | 2,271 | 2,403 | 2,521 | 2,598 | 2,140 | 2,220 | 2,266 | 2,274 | 2,242 | 2,280 | 2,318 |
| Taxes on EBIT: | | | | | | | | | | | | | |
| Add: Income taxes from income statement | 190 | 321 | 459 | 489 | 519 | 539 | 428 | 448 | 461 | 465 | 460 | | |
| Add: Tax shield on interest expenses | 24 | 24 | 27 | 29 | 31 | 33 | 34 | 35 | 36 | 38 | 39 | 40 | 41 |
| Less: Tax on Interest Income | (3) | (4) | (6) | (8) | (9) | (11) | (13) | (14) | (16) | (18) | (19) | (21) | (23) |
| Less: Tax on non-operating income | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Total Taxes on EBIT | (211) | (341) | (480) | (511) | (540) | (560) | (448) | (469) | (481) | (485) | (479) | (19) | (19) |
| Minority Interest | (119) | (161) | (190) | (202) | (214) | (223) | (177) | (185) | (191) | (192) | (190) | (195) | (199) |
| Change in deferred income taxes | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Goodwill Amortization | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividend from JCE and associates | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Net Operating Profits After Taxes, NOPAT | 1,176 | 1,408 | 1,602 | 1,690 | 1,766 | 1,815 | 1,515 | 1,566 | 1,594 | 1,597 | 1,574 | 2,066 | 2,100 |
| Depreciation & Amortization (except goodwill) | 624 | 675 | 717 | 754 | 789 | 822 | 852 | 881 | 910 | 939 | 968 | 997 | 1,026 |
| Net Change in Working Capital | 529 | 375 | 182 | 206 | 149 | 142 | 5 | 128 | 116 | 102 | 87 | 122 | 127 |
| Net Capital Expenditures | (1,200) | (1,100) | (900) | (900) | (800) | (800) | (700) | (700) | (700) | (700) | (700) | (700) | (700) |
| Free Cash Flows to the Firm (FCFF) | 1,129 | 1,358 | 1,601 | 1,749 | 1,904 | 1,979 | 1,673 | 1,875 | 1,921 | 1,938 | 1,928 | 2,485 | 2,553 |
| YoY Growth (%) | | 20.3% | 17.8% | 9.3% | 8.8% | 3.9% | -15.5% | 12.1% | 2.4% | 0.9% | -0.5% | | |
| Key Assumptions | | | | | | | | | | | | | |
| Risk Free Rate | 2.5% | | | | | | | | | | | | |
| Beta | 1.05 | | | | | | | | | | | | |
| Market risk premium (rm - rf) | 7.5% | | | | | | | | | | | | |
| Cost of Equity (re) | 10.4% | | | | | | | | | | | | |
| Cost of Preferred Equity (rp) | 0.0% | | | | | | | | | | | | |
| Cost of Debt | 4.5% | | | | | | | | | | | | |
| Effective Tax Rate | 25.0% | | | | | | | | | | | | |
| Market Value Preferred Stock/Capital Ratio | 0.0% | | | | | | | | | | | | |
| Market Value D/Capital Ratio | 40.0% | | | | | | | | | | | | |
| Weight Average Cost of Capital (WACC) | 7.6% | | | | | | | | | | | | |
| Terminal Growth Rate | 0.0% | | | | | | | | | | | | |
| Discounted Free Cash Flow Valuation | | | | | | | | | | | | | |
| PV of FCFF during 2011-2020 | 11,388 | | | | | | | | | | | | |
| Continuing value based on cash flows beyond Year 16 | 12,245 | | | | | | | | | | | | |
| Total Enterprise Value (Operating Value) | 23,633 | | | | | | | | | | | | |
| Add: Excess Cash & Non-operating Investments | 4,429 | | | | | | | | | | | | |
| Add: Cash from Share Options | 1,289 | | | | | | | | | | | | |
| Total Firm Value | 29,351 | | | | | | | | | | | | |
| Equity Valuation | | | | | | | | | | | | | |
| Total Firm Value | 29,351 | | | | | | | | | | | | |
| Less: Value of Interest Bearing Debt | 9,951 | | | | | | | | | | | | |
| Less: Value of Preferred Stock | - | | | | | | | | | | | | |
| Value of Common Equity | 19,400 | | | | | | | | | | | | |
| Number of Share Outstanding (mn) | 4,358 | | | | | | | | | | | | |
| Share Options (mn) | 842 | | | | | | | | | | | | |
| Fully diluted no. of shares (mn) | 5,200 | | | | | | | | | | | | |
| Equity Value per share (HK\$) | 3.73 | | | | | | | | | | | | |

Sensitivity table 1

---Terminal Growth Rate---

| | 0.00% | 0.25% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% | 1.75% |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|
| 6.00% | 5.01 | 5.17 | 5.34 | 5.53 | 5.74 | 5.97 | 6.23 | 6.51 |
| 6.25% | 4.76 | 4.91 | 5.06 | 5.23 | 5.42 | 5.62 | 5.85 | 6.10 |
| 6.50% | 4.54 | 4.67 | 4.81 | 4.96 | 5.12 | 5.31 | 5.51 | 5.73 |
| 6.75% | 4.33 | 4.44 | 4.57 | 4.71 | 4.86 | 5.02 | 5.20 | 5.39 |
| 7.00% | 4.13 | 4.24 | 4.35 | 4.48 | 4.61 | 4.76 | 4.92 | 5.09 |
| 7.25% | 3.95 | 4.05 | 4.15 | 4.27 | 4.39 | 4.52 | 4.66 | 4.82 |
| 7.50% | 3.78 | 3.87 | 3.97 | 4.07 | 4.18 | 4.30 | 4.43 | 4.57 |
| 7.75% | 3.63 | 3.71 | 3.79 | 3.89 | 3.99 | 4.10 | 4.21 | 4.34 |
| 8.00% | 3.48 | 3.55 | 3.63 | 3.72 | 3.81 | 3.91 | 4.01 | 4.13 |
| 8.25% | 3.34 | 3.41 | 3.48 | 3.56 | 3.64 | 3.73 | 3.83 | 3.93 |
| 8.50% | 3.21 | 3.27 | 3.34 | 3.41 | 3.49 | 3.57 | 3.66 | 3.75 |
| 8.75% | 3.09 | 3.14 | 3.21 | 3.27 | 3.34 | 3.42 | 3.50 | 3.58 |
| 9.00% | 2.97 | 3.02 | 3.08 | 3.14 | 3.21 | 3.28 | 3.35 | 3.43 |
| 9.25% | 2.86 | 2.91 | 2.96 | 3.02 | 3.08 | 3.14 | 3.21 | 3.28 |
| 9.50% | 2.76 | 2.80 | 2.85 | 2.90 | 2.96 | 3.02 | 3.08 | 3.15 |
| 9.75% | 2.66 | 2.70 | 2.75 | 2.80 | 2.85 | 2.90 | 2.96 | 3.02 |
| 10.00% | 2.57 | 2.61 | 2.65 | 2.69 | 2.74 | 2.79 | 2.84 | 2.90 |
| 10.25% | 2.48 | 2.51 | 2.55 | 2.60 | 2.64 | 2.69 | 2.73 | 2.79 |

--WACC--

Source: Nomura estimates

Risks to our investment view

Upside risks to our price target include: 1) higher-than-expected gas volume sales to higher margin C&I and vehicle users; 2) value-constructive acquisition; 3) continuous picking up for the LPG business margin and volume; and 4) possibility of being an acquisition target amid industry consolidation in the long-term.

Exhibit 84. China Gas: project details I

| Segment | Province | Location | As at 30 June 2010 | | As at 31 March 2010 | | | | Shareholding (%) |
|----------|----------|--------------------|-----------------------|-----------------------|------------------------|----------------------------------|--|--|------------------|
| | | | Total population (mn) | Urban population (mn) | Connectable Households | Accumulated connected households | Accumulated connected industrial customers | Accumulated connected commercial customers | |
| City Gas | Anhui | Wuhu | 2.3 | 1.1 | 313,000 | 227,287 | 81 | 471 | 90 |
| | | Huainan | 2.1 | 1.5 | 469,000 | 121,774 | 4 | 159 | 100 |
| | | Shouxian | 1.3 | 0.2 | 47,000 | 4,784 | - | 3 | 90 |
| | | Suzhou | 5.7 | 0.4 | 133,000 | 75,027 | 2 | 117 | 75 |
| | | Wuhuxian | 0.4 | 0.1 | 25,000 | 9,241 | 22 | 59 | 100 |
| | | Nanlingxian | 0.5 | 0.1 | 39,000 | 10,011 | | | 100 |
| | | Huoshanxian | 0.4 | 0.1 | 32,000 | 2,030 | - | 4 | 100 |
| | | Fengtaixian | 0.6 | 0.1 | 28,000 | 6,072 | - | 8 | 100 |
| | | Wuweixian | 1.4 | 0.2 | 56,000 | 4,062 | - | - | 90 |
| | | Xiuningxian | 0.3 | 0.0 | 7,000 | | | | 100 |
| | Hubei | Yichang | 4.0 | 1.2 | 378,000 | 126,076 | 18 | 471 | 70 |
| | | Xiaogan | 0.9 | 0.2 | 72,000 | 56,918 | 15 | 110 | 100 |
| | | Hanchuan | 1.1 | 0.2 | 54,000 | 25,025 | 77 | 99 | 100 |
| | | Yingcheng | 0.7 | 0.2 | 55,000 | 28,156 | 4 | 111 | 100 |
| | | Yunmeng | 0.6 | 0.1 | 37,000 | 17,184 | 5 | 112 | 100 |
| | | Suizhou | 2.6 | 0.8 | 244,000 | 44,000 | 13 | 106 | 100 |
| | | Tianmen | 1.6 | 0.2 | 63,000 | 12,555 | 1 | 54 | 100 |
| | | Dangyang | 0.6 | 0.1 | 44,000 | 2,487 | 4 | 8 | 100 |
| | Hunan | Yiyang Yuanjian | 4.6 | 0.9 | 269,000 | 62,928 | 5 | 88 | 80 |
| | | Yuxian | 0.8 | 0.2 | 76,875 | | | | 100 |
| | | Zhangjiajie | 1.6 | 0.4 | 120,000 | | | | 100 |
| | Jiangsu | Pizhou | 1.6 | 0.2 | 72,000 | 25,703 | - | 26 | 100 |
| | | Yangzhong | 0.3 | 0.1 | 28,000 | 26,698 | 12 | 224 | 100 |
| | | Jiang Bei, Nanjing | 1.2 | 1.2 | 375,000 | 118,134 | 11 | 30 | 100 |
| | | Pu Kou, Nanjing | 0.5 | 0.3 | 106,250 | 19,387 | | | 100 |
| | | Jiawang, Xuzhou | 0.5 | 0.2 | 56,000 | 5,430 | - | 8 | 100 |
| | | Xinyi, Xuzhou | 1.0 | 0.2 | 50,000 | 11,667 | 1 | 15 | 100 |
| | | Yangzhou | 4.6 | 1.2 | 381,000 | 139,065 | 5 | 321 | 50 |
| | Zhejiang | Xiaoshan, Hangzhou | 1.2 | 1.2 | 362,000 | 8,469 | 42 | 8 | 100 |
| | | Shaoxingxian | 0.7 | 0.5 | 156,000 | | | | 55 |
| | | Taizhou | 0.6 | 0.6 | 160,000 | 22,470 | 4 | 114 | 50 |
| | | Jinhua | 4.6 | 0.9 | 288,000 | 40,149 | - | 54 | 50 |
| | Hebei | Cangzhou | 6.7 | 0.5 | 147,000 | 1,525 | 11 | 3 | 70 |
| | | Nanpixian | 0.8 | 0.1 | 16,000 | 3,456 | 3 | 3 | 100 |
| | | Qinghexian | 0.3 | 0.1 | 23,000 | 608 | - | 2 | 100 |
| | | Wangdu | 0.2 | 0.0 | 10,000 | 3,585 | 10 | 20 | 100 |
| | | Tangshan Nampo | 0.2 | 0.1 | 23,000 | 14,392 | 3 | 25 | 100 |
| | | Pingshanxian, | 4.3 | 0.8 | 246,000 | 76,204 | 90 | 130 | 60 |
| | | Bohai New Zone | 0.8 | 0.8 | 234,000 | | | | 70 |

Source: Company data, Nomura research

Exhibit 85. China Gas: project details II

| Segment | Province | Location | As at 30 June 2010 | | As at 31 March 2010 | | | | Shareholding (%) |
|---------|-----------|---------------------|-----------------------|-----------------------|------------------------|----------------------------------|--|--|------------------|
| | | | Total population (mn) | Urban population (mn) | Connectable households | Accumulated connected households | Accumulated connected industrial customers | Accumulated connected commercial customers | |
| | Guangxi | Yulin | 6.0 | 0.7 | 188,000 | 22,727 | 1 | 45 | 100 |
| | | Qinzhou | 3.3 | 0.4 | 125,000 | 16,371 | - | 52 | 100 |
| | | Liuzhou | 3.6 | 1.3 | 406,000 | 107,962 | 1 | 388 | 50 |
| | | Fangchenggang | 0.7 | 0.2 | 63,000 | 1,737 | 1 | 1 | 100 |
| | | Nanning | 0.2 | 0.2 | 62,500 | | | | 100 |
| | | ASEAN Develop. Zone | | | | | | | |
| | | Laibin | 2.5 | 0.3 | 78,125 | | | | 100 |
| | | Baise | 3.7 | 0.3 | 103,125 | | | | 100 |
| | | Bobai | 1.8 | 0.2 | 70,000 | | | | 100 |
| | | Nanning | 6.9 | 2.6 | 740,000 | 232,761 | 1 | 680 | 100 |
| | Shaanxi | Baoji | 3.7 | 1.0 | 319,000 | 219,028 | 46 | 526 | 64 |
| | | Qishanxian | 0.5 | 0.2 | 47,000 | | | | 100 |
| | | Yulin | 3.4 | 0.5 | 156,000 | | | | 60 |
| | | Linyouxian | 0.1 | 0.0 | 8,333 | | | | 100 |
| | | Maoming | 6.7 | 1.2 | 375,000 | 5,339 | - | 4 | 100 |
| | Guangdong | Conghua | 0.6 | 0.3 | 94,000 | 10,766 | 1 | 6 | 100 |
| | | Meizhou | 1.2 | 0.9 | 250,000 | 2,746 | 1 | 5 | 100 |
| | | Yunfu | 2.6 | 0.3 | 100,000 | 1,813 | - | 1 | 100 |
| | | Shanwei | 3.2 | 0.4 | 109,000 | 321 | - | 1 | 100 |
| | | Xinxing | 0.5 | 0.1 | 30,000 | | | | 100 |
| | | Fengshun | 0.7 | 0.2 | 70,000 | | | | 100 |
| | | Pingyuan | 0.3 | 0.1 | 15,000 | | | | 100 |
| | | Fushun | 2.3 | 1.4 | 442,000 | 225,066 | 1 | 6,115 | 70 |
| | Liaoning | Dailian | 6.0 | 3.1 | 976,000 | | | | 75 |
| | | Jinzhou | 0.1 | 0.1 | 25,000 | 4,897 | - | 5 | 51 |
| | | Shenyang | 0.4 | 0.4 | 112,000 | 26,431 | - | 13 | 100 |
| | | Sujiatun | | | | | | | |
| | | Dailian Jinzhou | 0.8 | 0.5 | 140,625 | 7,604 | - | 13 | 100 |
| | | Liaoyang | 1.8 | 0.7 | 223,750 | 21,806 | 35 | 252 | 80 |
| | | Gaizhou | 0.7 | 0.3 | 103,000 | 706 | - | 1 | 100 |
| | | Zhuanghe | 0.9 | 0.3 | 88,867 | | 1 | 2 | 100 |
| | | Linghai | 0.6 | 0.2 | 65,625 | | | | 100 |
| | | Pulandian | 0.8 | 0.3 | 93,750 | | | | 100 |
| | Chongqing | Yubei | 0.9 | 0.9 | 274,000 | 81,429 | 24 | 5,726 | 98 |
| | Shandong | Dezhou | 5.6 | 1.6 | 475,000 | 114,896 | 15 | 1,007 | 51 |
| | | Qingdao | 7.6 | 2.8 | 940,000 | 546,732 | 1 | 2,033 | 51 |

Source: Company data, Nomura research

Exhibit 86. China Gas: project details III

| Segment | Province | Location | As at 30 June 2010 | | As at 31 March 2010 | | | | Shareholding (%) |
|------------------------|------------------|-------------------|-----------------------|-----------------------|------------------------|----------------------------------|--|--|------------------|
| | | | Total population (mn) | Urban population (mn) | Connectable households | Accumulated connected households | Accumulated connected industrial customers | Accumulated connected commercial customers | |
| | Inner Mongolia | Hohhot | 2.6 | 1.7 | 531,000 | 328,649 | 74 | 4,431 | 50 |
| | | Wuzhen | 0.1 | 0.0 | 9,000 | 9,307 | - | - | 100 |
| | | Baotou | 2.1 | 1.3 | 406,000 | 144,712 | 29 | 270 | 80 |
| | | Helingeer | 0.2 | 0.1 | 30,000 | | | | 100 |
| | | Tuoketuo | 0.2 | 0.1 | 40,000 | | | | 100 |
| | | Tuzuo | 0.4 | 0.1 | 31,667 | | | | 100 |
| | | Wuchuan | 0.2 | 0.1 | 20,000 | | | | 100 |
| | | Otog | 0.1 | 0.1 | 15,938 | | | | 100 |
| | Heilongjiang | Harbin | 10.0 | 5.0 | 1,562,000 | 1,047,330 | 65 | 7,510 | 48 |
| | | Jiamusi | 2.5 | 0.8 | 256,250 | 47,125 | 1 | 84 | 57 |
| | | Shuangcheng | 0.9 | 0.3 | 78,125 | | | | 100 |
| | | Mudanjiang | 2.8 | 0.8 | 200,000 | 17,307 | 1 | 87 | 100 |
| | | Jiagedaqi | 0.6 | 0.2 | 50,000 | | | | 100 |
| | Ningxia | Zhongwei | 1.1 | 0.6 | 175,000 | 5,903 | 1 | 11 | 100 |
| | Fujian | 29 cities/regions | 4.0 | 4.0 | 1,200,000 | 181,936 | 41 | 182 | 49 |
| | Jiangxi | Nanchang Wanli | 0.1 | 0.0 | 10,000 | | | | 100 |
| | Total | | | 171.9 | 55.9 | 17,278,805 | 4,785,966 | 784 | 32,414 |
| Zhongyu Gas | Henan & Shandong | | | | | | | | 56 |
| Long Distance Pipeline | Inner Mongolia | Otog Banner | | | | | 1 | | |
| | | Wushen Banner | | | | | 1 | | |
| | Tianjin | Tianjin | | | | | 2 | | |
| | Hubei | Xiaogan | | | | | 1 | | |
| | | Dangyang | | | | | 1 | | |
| | | Huanggang-Daye | | | | | | | |
| | Hebei | Huanghua | | | | | 2 | | |
| | Chongqing | Chongqing | | | | | | | |

Source: Company data, Nomura research

Financial statements

| Income statement (HK\$mn) | | | | | |
|---------------------------------------|------------|--------------|--------------|--------------|--------------|
| Year-end 31 Mar | FY08 | FY09 | FY10 | FY11 | FY12F |
| Revenue | 2,552 | 6,324 | 10,212 | 14,741 | 18,747 |
| Cost of goods sold | (1,806) | (4,894) | (8,096) | (11,878) | (15,069) |
| Gross profit | 746 | 1,429 | 2,116 | 2,863 | 3,678 |
| SG&A | (448) | (743) | (890) | (1,356) | (1,769) |
| Employee share expense | | | | | |
| Operating profit | 298 | 687 | 1,227 | 1,507 | 1,910 |
| EBITDA | 504 | 1,054 | 1,749 | 2,131 | 2,585 |
| Depreciation | (189) | (334) | (475) | (552) | (602) |
| Amortisation | (16) | (33) | (48) | (72) | (74) |
| EBIT | 298 | 687 | 1,227 | 1,507 | 1,910 |
| Net interest expense | (185) | (351) | (488) | (460) | (429) |
| Associates & JCEs | 138 | 13 | (114) | 11 | 11 |
| Other income | (50) | (144) | 549 | - | - |
| Earnings before tax | 201 | 205 | 1,174 | 1,057 | 1,492 |
| Income tax | (14) | (71) | (158) | (190) | (321) |
| Net profit after tax | 188 | 134 | 1,016 | 867 | 1,171 |
| Minority interests | (47) | (30) | (140) | (119) | (161) |
| Other items | | | | | |
| Preferred dividends | | | | | |
| Normalised NPAT | 141 | 104 | 876 | 747 | 1,010 |
| Extraordinary items | - | - | - | - | - |
| Reported NPAT | 141 | 104 | 876 | 747 | 1,010 |
| Dividends | (39) | (40) | (47) | (73) | (87) |
| Transfer to reserves | 102 | 64 | 829 | 675 | 923 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 110.4 | 150.8 | 21.7 | 30.8 | 22.8 |
| FD normalised P/E at price target (x) | 92.4 | 126.3 | 18.2 | 25.7 | 19.1 |
| Reported P/E (x) | 100.6 | 142.1 | 16.9 | 22.8 | 19.1 |
| Dividend yield (%) | 0.3 | 0.3 | 0.3 | 0.4 | 0.5 |
| Price/cashflow (x) | 22.5 | 14.4 | 11.8 | 6.9 | 7.3 |
| Price/book (x) | 4.7 | 4.6 | 3.6 | 2.4 | 2.2 |
| EV/EBITDA (x) | 31.7 | 22.8 | 15.6 | 10.1 | 7.9 |
| EV/EBIT (x) | 46.7 | 34.8 | 23.0 | 14.2 | 10.7 |
| Gross margin (%) | 29.2 | 22.6 | 20.7 | 19.4 | 19.6 |
| EBITDA margin (%) | 19.7 | 16.7 | 17.1 | 14.5 | 13.8 |
| EBIT margin (%) | 11.7 | 10.9 | 12.0 | 10.2 | 10.2 |
| Net margin (%) | 5.5 | 1.6 | 8.6 | 5.1 | 5.4 |
| Effective tax rate (%) | 6.8 | 34.8 | 13.5 | 18.0 | 21.5 |
| Dividend payout (%) | 27.4 | 38.6 | 5.3 | 9.7 | 8.6 |
| Capex to sales (%) | 51.6 | 27.5 | 12.5 | 8.1 | 5.9 |
| Capex to depreciation (x) | 7.0 | 5.2 | 2.7 | 2.2 | 1.8 |
| ROE (%) | 5.1 | 3.3 | 23.8 | 12.3 | 12.0 |
| ROA (pretax %) | 5.6 | 5.4 | 6.3 | 7.6 | 8.9 |
| Growth (%) | | | | | |
| Revenue | 106.4 | 147.8 | 61.5 | 44.3 | 27.2 |
| EBITDA | 65.1 | 109.2 | 66.0 | 21.8 | 21.3 |
| EBIT | 46.4 | 130.3 | 78.6 | 22.8 | 26.8 |
| Normalised EPS | (34.4) | (29.2) | 741.9 | (26.0) | 19.7 |
| Normalised FDEPS | (31.9) | (26.8) | 593.8 | (29.3) | 35.1 |
| Per share | | | | | |
| Reported EPS (HK\$) | 0.04 | 0.03 | 0.26 | 0.19 | 0.23 |
| Norm EPS (HK\$) | 0.04 | 0.03 | 0.26 | 0.19 | 0.23 |
| Fully diluted norm EPS (HK\$) | 0.04 | 0.03 | 0.20 | 0.14 | 0.19 |
| Book value per share (HK\$) | 0.94 | 0.97 | 1.23 | 1.83 | 2.04 |
| DPS (HK\$) | 0.01 | 0.01 | 0.01 | 0.02 | 0.02 |

Source: Nomura estimates

Cashflow (HK\$mn)

| Year-end 31 Mar | FY08 | FY09 | FY10 | FY11 | FY12F |
|--------------------------------------|----------------|----------------|--------------|--------------|--------------|
| EBITDA | 504 | 1,054 | 1,749 | 2,131 | 2,585 |
| Change in working capital | 292 | 822 | 204 | 529 | 375 |
| Other operating cashflow | (164) | (854) | (702) | (190) | (321) |
| Cashflow from operations | 632 | 1,023 | 1,252 | 2,469 | 2,639 |
| Capital expenditure | (1,317) | (1,741) | (1,278) | (1,200) | (1,100) |
| Free cashflow | (686) | (718) | (26) | 1,269 | 1,539 |
| Reduction in investments | (70) | (45) | (52) | - | - |
| Net acquisitions | (620) | (292) | (715) | - | - |
| Reduction in other LT assets | (448) | (520) | 115 | (11) | (11) |
| Addition in other LT liabilities | 129 | 508 | (92) | 0 | - |
| Adjustments | (245) | 59 | 427 | 77 | 86 |
| Cashflow after investing acts | (1,941) | (1,007) | (343) | 1,335 | 1,615 |
| Cash dividends | (39) | (87) | (79) | (73) | (87) |
| Equity issue | 50 | 2 | 14 | 3,185 | - |
| Debt issue | 2,037 | 1,879 | 2,768 | (3,365) | 1,667 |
| Convertible debt issue | | | | | |
| Others | (80) | (248) | (537) | (526) | (504) |
| Cashflow from financial acts | 1,968 | 1,546 | 2,167 | (779) | 1,076 |
| Net cashflow | 27 | 539 | 1,824 | 556 | 2,691 |
| Beginning cash | 1,483 | 1,510 | 2,049 | 3,872 | 4,429 |
| Ending cash | 1,510 | 2,049 | 3,872 | 4,429 | 7,119 |
| Ending net debt | 4,286 | 8,264 | 9,444 | 5,522 | 4,499 |

Source: Nomura estimates

Balance sheet (HK\$mn)

| As at 31 Mar | FY08 | FY09 | FY10 | FY11 | FY12F |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & equivalents | 1,510 | 2,049 | 3,872 | 4,429 | 7,119 |
| Marketable securities | 42 | 12 | 15 | 15 | 15 |
| Accounts receivable | 936 | 1,286 | 1,871 | 2,701 | 3,435 |
| Inventories | 286 | 541 | 564 | 828 | 1,050 |
| Other current assets | 624 | 1,328 | 761 | 787 | 823 |
| Total current assets | 3,398 | 5,215 | 7,084 | 8,760 | 12,443 |
| LT investments | 219 | 295 | 343 | 343 | 343 |
| Fixed assets | 5,566 | 9,132 | 11,064 | 11,712 | 12,210 |
| Goodwill | 418 | 684 | 901 | 901 | 901 |
| Other intangible assets | 716 | 1,189 | 2,212 | 2,141 | 2,069 |
| Other LT assets | 989 | 1,508 | 1,393 | 1,404 | 1,415 |
| Total assets | 11,306 | 18,025 | 22,998 | 25,261 | 29,381 |
| Short-term debt | 171 | 3,104 | 5,295 | 4,422 | 5,624 |
| Accounts payable | 1,349 | 2,603 | 3,182 | 4,669 | 5,923 |
| Other current liabilities | 32 | 174 | 409 | 572 | 686 |
| Total current liabilities | 1,552 | 5,881 | 8,886 | 9,663 | 12,233 |
| Long-term debt | 5,624 | 7,194 | 8,021 | 5,529 | 5,994 |
| Convertible debt | - | 15 | - | - | - |
| Other LT liabilities | 444 | 952 | 860 | 860 | 860 |
| Total liabilities | 7,620 | 14,043 | 17,767 | 16,051 | 19,087 |
| Minority interest | 545 | 759 | 1,107 | 1,227 | 1,388 |
| Preferred stock | | | | | |
| Common stock | 33 | 33 | 34 | 44 | 44 |
| Retained earnings | 2,659 | 2,447 | 3,200 | 6,583 | 7,093 |
| Proposed dividends | 448 | 743 | 890 | 1,356 | 1,769 |
| Other equity and reserves | - | - | - | - | - |
| Total shareholders' equity | 3,141 | 3,223 | 4,123 | 7,983 | 8,905 |
| Total equity & liabilities | 11,306 | 18,025 | 22,998 | 25,261 | 29,381 |

Liquidity (x)

| | | | | | |
|----------------|------|------|------|------|------|
| Current ratio | 2.19 | 0.89 | 0.80 | 0.91 | 1.02 |
| Interest cover | 1.6 | 2.0 | 2.5 | 3.3 | 4.5 |

Leverage

| | | | | | |
|---------------------|-------|-------|-------|------|------|
| Net debt/EBITDA (x) | 8.51 | 7.84 | 5.40 | 2.59 | 1.74 |
| Net debt/equity (%) | 136.5 | 256.4 | 229.1 | 69.2 | 50.5 |

Activity (days)

| | | | | | |
|-----------------|--------|--------|--------|--------|--------|
| Days receivable | 118.7 | 64.1 | 56.4 | 56.6 | 59.9 |
| Days inventory | 42.8 | 30.8 | 24.9 | 21.4 | 22.8 |
| Days payable | 223.7 | 147.4 | 130.4 | 120.6 | 128.6 |
| Cash cycle | (62.2) | (52.4) | (49.1) | (42.6) | (45.9) |

Source: Nomura estimates

Action

Wellhead price passthrough is ongoing, with an overall neutral impact on the company. The HK business remains stagnant and growth potential rests mainly with the China business. At HK\$19.02, HKCG is trading at 25.8x FY11F P/E, vs the pure China gas distributors of 19.6x and HK utilities at 17.1x. REDUCE reiterated on rich valuations; our price target of HK\$16.5 puts potential downside at 13.2%.

Catalysts

Acquisition of new city-gas projects in China, large M&A of other industry players, share buybacks, special dividend and increased gas supply are possible catalysts.

Anchor themes

HK utilities offer a defensive portfolio for investors in 2010F, underpinned by strong dividend yields (4-5%), a favourable regulatory regime (guaranteed 10% ROA) and under-gear balance sheets.

Closing price on 2 Nov HK\$19.02

Price target **HK\$16.50**
(set on 27 Jul 10)

Upside/downside -13.2%

Difference from consensus **5.8%**

FY11F net profit (HK\$m) 5,295

Difference from consensus **-0.8%**

Source: Nomura

Nomura vs consensus

We factor in higher capex post FY12F, a 25% three-year earnings CAGR and a 5% terminal growth rate for China.

Valuation remains a concern

① HK stagnant; growth coming from China

The HK business remains stagnant and, on our reading, will remain flat in the coming years. As we see it, HKCG's growth is reliant on the China business. Management is targeting >8bcm of gas sales in FY10F. The company is also positive on new energy projects in China, which it targets to contribute 50% of earnings at the China utilities business starting from 2012F.

② Wellhead passthrough in progress

HKCG received a tariff increase for its commercial and industrial customers following the wellhead price increase. According to management, the hike is at an average of RMB0.3/m³ — higher than the wellhead price increase of RMB0.23/m³. Public hearings are still ongoing for residential customers and will likely take a few months, we believe.

③ HK\$10bn capex for China business

HKCG plans to allocate HK\$10bn of capex to its China business during FY10-12F. According to management's plans, about a third of this sum will be used in city gas and mid-stream projects; the remainder will be for new energy projects. It targets to secure 10-12 new city gas projects a year (including Towngas China).

④ Demanding valuations; reiterating REDUCE; risks

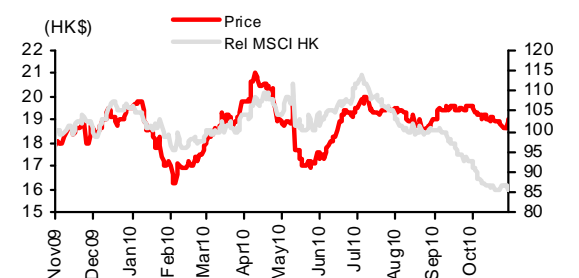
We find HKCG unattractive on valuation grounds. The stock is trading at 25.8x FY11F P/E, on our numbers, vs 19.6x for pure China gas distributors and 17.1x for HK utilities. We see the premium as unjustified because of HKCG's stagnant HK business, declining investment income, tail-ending property earnings and slowing China growth (albeit from a large base). We reiterate our REDUCE rating with price target of HK\$16.5. **Upside investment risks:** acquisition of additional city-gas projects in China; increased gas tariffs in HK.

Key financials & valuations

| 31 Dec (HK\$m) | FY09 | FY10F | FY11F | FY12F |
|---------------------------|--------|--------|--------|--------|
| Revenue | 12,352 | 14,467 | 15,608 | 16,854 |
| Reported net profit | 5,175 | 4,839 | 5,295 | 5,733 |
| Normalised net profit | 5,175 | 4,839 | 5,295 | 5,733 |
| Normalised EPS (HK\$) | 0.79 | 0.67 | 0.74 | 0.80 |
| Norm. EPS growth (%) | 21.9 | (14.4) | 9.4 | 8.3 |
| Norm. P/E (x) | 24.2 | 28.2 | 25.8 | 23.8 |
| EV/EBITDA (x) | 19.8 | 18.5 | 17.4 | 16.3 |
| Price/book (x) | 3.8 | 3.9 | 3.6 | 3.4 |
| Dividend yield (%) | 1.8 | 2.1 | 2.4 | 2.6 |
| ROE (%) | 16.3 | 14.2 | 14.5 | 14.6 |
| Net debt/equity (%) | 22.1 | 22.4 | 22.9 | 23.6 |
| Earnings revisions | | | | |
| Previous norm. net profit | | 4,839 | 5,295 | 5,733 |
| Change from previous (%) | | - | - | - |
| Previous norm. EPS (HK\$) | | 0.67 | 0.74 | 0.80 |

Source: Company, Nomura estimates

Share price relative to MSCI HK



| | 1m | 3m | 6m |
|----------------------------------|-------|--------|-------------|
| Absolute (HK\$) | (3.2) | (2.5) | 0.1 |
| Absolute (US\$) | (3.0) | (2.3) | 0.3 |
| Relative to Index | (7.9) | (20.5) | (21.0) |
| Market cap (US\$m) | | | 16,022 |
| Estimated free float (%) | | | 52.1 |
| 52-week range (HK\$) | | | 21.00/16.24 |
| 3-mth avg daily turnover (US\$m) | | | 15.08 |
| Stock borrowability | | | Easy |
| Major shareholders (%) | | | |
| Timpani Investment | | | 30.5 |
| Chelco Investment | | | 9.4 |

Source: Company, Nomura estimates

Financial statements

| Income statement (HK\$mn) | | | | | |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
| Revenue | 12,352 | 12,352 | 14,467 | 15,608 | 16,854 |
| Cost of goods sold | (4,981) | (3,990) | (5,347) | (6,096) | (6,858) |
| Gross profit | 7,371 | 8,361 | 9,119 | 9,512 | 9,996 |
| SG&A | (3,757) | (4,500) | (4,530) | (4,717) | (4,941) |
| Employee share expense | - | - | - | - | - |
| Operating profit | 3,614 | 3,861 | 4,589 | 4,795 | 5,055 |
| EBITDA | 4,322 | 4,698 | 5,549 | 5,801 | 6,107 |
| Depreciation | (708) | (836) | (960) | (1,006) | (1,052) |
| Amortisation | - | - | - | - | - |
| EBIT | 3,614 | 3,861 | 4,589 | 4,795 | 5,055 |
| Net interest expense | (176) | (461) | (668) | (632) | (696) |
| Associates & JCEs | 2,345 | 1,935 | 1,575 | 1,826 | 2,102 |
| Other income | (826) | 721 | 75 | 75 | 75 |
| Earnings before tax | 4,957 | 6,056 | 5,571 | 6,065 | 6,536 |
| Income tax | (563) | (747) | (607) | (633) | (654) |
| Net profit after tax | 4,395 | 5,309 | 4,964 | 5,432 | 5,882 |
| Minority interests | (92) | (134) | (125) | (137) | (149) |
| Other items | - | - | - | - | - |
| Preferred dividends | - | - | - | - | - |
| Normalised NPAT | 4,303 | 5,175 | 4,839 | 5,295 | 5,733 |
| Extraordinary items | - | - | - | - | - |
| Reported NPAT | 4,303 | 5,175 | 4,839 | 5,295 | 5,733 |
| Dividends | (2,333) | (2,285) | (2,873) | (3,232) | (3,519) |
| Transfer to reserves | 1,969 | 2,890 | 1,966 | 2,063 | 2,214 |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 29.5 | 24.2 | 28.2 | 25.8 | 23.8 |
| FD normalised P/E at price target (x) | 25.6 | 21.0 | 24.5 | 22.4 | 20.7 |
| Reported P/E (x) | 29.5 | 24.2 | 28.2 | 25.8 | 23.8 |
| Dividend yield (%) | 1.8 | 1.8 | 2.1 | 2.4 | 2.6 |
| Price/cashflow (x) | 25.5 | 31.5 | 27.0 | 25.2 | 23.9 |
| Price/book (x) | 4.1 | 3.8 | 3.9 | 3.6 | 3.4 |
| EV/EBITDA (x) | 19.0 | 19.8 | 18.5 | 17.4 | 16.3 |
| EV/EBIT (x) | 21.2 | 22.7 | 21.4 | 20.1 | 18.7 |
| Gross margin (%) | 59.7 | 67.7 | 63.0 | 60.9 | 59.3 |
| EBITDA margin (%) | 35.0 | 38.0 | 38.4 | 37.2 | 36.2 |
| EBIT margin (%) | 29.3 | 31.3 | 31.7 | 30.7 | 30.0 |
| Net margin (%) | 34.8 | 41.9 | 33.4 | 33.9 | 34.0 |
| Effective tax rate (%) | 11.3 | 12.3 | 10.9 | 10.4 | 10.0 |
| Dividend payout (%) | 54.2 | 44.2 | 59.4 | 61.0 | 61.4 |
| Capex to sales (%) | 23.5 | 22.3 | 22.3 | 19.8 | 18.9 |
| Capex to depreciation (x) | 4.1 | 3.3 | 3.4 | 3.1 | 3.0 |
| ROE (%) | 14.5 | 16.3 | 14.2 | 14.5 | 14.6 |
| ROA (pretax %) | 15.3 | 12.5 | 11.2 | 11.2 | 11.3 |
| Growth (%) | | | | | |
| Revenue | (13.2) | (0.0) | 17.1 | 7.9 | 8.0 |
| EBITDA | (27.8) | 8.7 | 18.1 | 4.6 | 5.3 |
| EBIT | (31.8) | 6.8 | 18.8 | 4.5 | 5.4 |
| Normalised EPS | (53.6) | 21.9 | (14.4) | 9.4 | 8.3 |
| Normalised FDEPS | (53.6) | 21.9 | (14.4) | 9.4 | 8.3 |
| Per share | | | | | |
| Reported EPS (HK\$) | 0.65 | 0.79 | 0.67 | 0.74 | 0.80 |
| Norm EPS (HK\$) | 0.65 | 0.79 | 0.67 | 0.74 | 0.80 |
| Fully diluted norm EPS (HK\$) | 0.65 | 0.79 | 0.67 | 0.74 | 0.80 |
| Book value per share (HK\$) | 4.60 | 5.03 | 4.92 | 5.27 | 5.64 |
| DPS (HK\$) | 0.35 | 0.35 | 0.40 | 0.45 | 0.49 |

Source: Nomura estimates

Higher 2009 earnings partly due to one-off gains

Cashflow (HK\$mn)

| Year-end 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|--------------------------------------|--------------|----------------|----------------|----------------|----------------|
| EBITDA | 4,322 | 4,698 | 5,549 | 5,801 | 6,107 |
| Change in working capital | 1,103 | 1,262 | (52) | 90 | 74 |
| Other operating cashflow | (461) | (1,985) | (429) | (476) | (472) |
| Cashflow from operations | 4,965 | 3,975 | 5,068 | 5,415 | 5,709 |
| Capital expenditure | (2,902) | (2,756) | (3,219) | (3,086) | (3,183) |
| Free cashflow | 2,063 | 1,219 | 1,849 | 2,329 | 2,526 |
| Reduction in investments | 1,139 | 362 | (325) | (494) | (628) |
| Net acquisitions | (394) | (365) | (1,100) | (1,100) | (1,133) |
| Reduction in other LT assets | (1,910) | (3,423) | (1,100) | (1,100) | (1,133) |
| Addition in other LT liabilities | 430 | 313 | 228 | 152 | 162 |
| Adjustments | 1,834 | 4,040 | 3,575 | 3,253 | 3,564 |
| Cashflow after investing acts | 3,162 | 2,146 | 3,127 | 3,040 | 3,357 |
| Cash dividends | (2,260) | (2,376) | (2,579) | (3,052) | (3,376) |
| Equity issue | - | (1,999) | (515) | 0 | - |
| Debt issue | 6,762 | 3,335 | (3,224) | - | (1,000) |
| Convertible debt issue | - | - | (12) | - | - |
| Others | (156) | (283) | (706) | (738) | (836) |
| Cashflow from financial acts | 4,346 | (1,323) | (7,036) | (3,791) | (5,211) |
| Net cashflow | 7,508 | 822 | (3,909) | (751) | (1,854) |
| Beginning cash | 4,839 | 12,347 | 13,169 | 9,260 | 8,510 |
| Ending cash | 12,347 | 13,169 | 9,260 | 8,510 | 6,656 |
| Ending net debt | 2,238 | 7,250 | 7,935 | 8,686 | 9,540 |

Source: Nomura estimates

Balance sheet (HK\$mn)

| As at 31 Dec | FY08 | FY09 | FY10F | FY11F | FY12F |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & equivalents | 12,347 | 13,169 | 9,260 | 8,510 | 6,656 |
| Marketable securities | 767 | 405 | 730 | 1,224 | 1,852 |
| Accounts receivable | 2,631 | 3,396 | 3,977 | 4,291 | 4,634 |
| Inventories | 1,916 | 2,617 | 3,051 | 3,285 | 3,541 |
| Other current assets | 47 | 35 | 36 | 37 | 38 |
| Total current assets | 17,708 | 19,622 | 17,055 | 17,346 | 16,720 |
| LT investments | - | - | - | - | - |
| Fixed assets | 15,638 | 24,453 | 26,393 | 28,301 | 30,245 |
| Goodwill | - | - | - | - | - |
| Other intangible assets | - | - | - | - | - |
| Other LT assets | 18,608 | 22,031 | 23,131 | 24,231 | 25,364 |
| Total assets | 51,954 | 66,106 | 66,579 | 69,878 | 72,329 |
| Short-term debt | 2,243 | 4,748 | 5,050 | 5,050 | 4,050 |
| Accounts payable | 2,781 | 5,324 | 6,194 | 6,781 | 7,399 |
| Other current liabilities | 385 | 557 | 652 | 704 | 760 |
| Total current liabilities | 5,408 | 10,629 | 11,896 | 12,534 | 12,209 |
| Long-term debt | 12,343 | 15,672 | 12,146 | 12,146 | 12,146 |
| Convertible debt | - | - | - | - | - |
| Other LT liabilities | 2,704 | 3,017 | 3,245 | 3,397 | 3,559 |
| Total liabilities | 20,454 | 29,317 | 27,287 | 28,077 | 27,913 |
| Minority interest | 848 | 3,942 | 3,942 | 3,942 | 3,942 |
| Preferred stock | - | - | - | - | - |
| Common stock | 1,666 | 1,632 | 1,620 | 1,620 | 1,620 |
| Retained earnings | 19,278 | 23,503 | 25,469 | 27,531 | 29,745 |
| Proposed dividends | 1,533 | 1,502 | 2,011 | 2,370 | 2,657 |
| Other equity and reserves | 8,174 | 6,209 | 6,249 | 6,337 | 6,450 |
| Total shareholders' equity | 30,652 | 32,846 | 35,349 | 37,858 | 40,473 |
| Total equity & liabilities | 51,954 | 66,106 | 66,579 | 69,878 | 72,329 |

Liquidity (x)

| | | | | | |
|----------------|------|------|------|------|------|
| Current ratio | 3.27 | 1.85 | 1.43 | 1.38 | 1.37 |
| Interest cover | 20.5 | 8.4 | 6.9 | 7.6 | 7.3 |

Leverage

| | | | | | |
|---------------------|------|------|------|------|------|
| Net debt/EBITDA (x) | 0.52 | 1.54 | 1.43 | 1.50 | 1.56 |
| Net debt/equity (%) | 7.3 | 22.1 | 22.4 | 22.9 | 23.6 |

Activity (days)

| | | | | | |
|-----------------|-------|--------|---------|---------|--------|
| Days receivable | 114.0 | 89.1 | 93.0 | 96.7 | 96.9 |
| Days inventory | 110.3 | 207.3 | 193.5 | 189.7 | 182.1 |
| Days payable | 219.2 | 370.7 | 393.1 | 388.4 | 378.4 |
| Cash cycle | 5.2 | (74.3) | (106.6) | (102.1) | (99.3) |

Source: Nomura estimates



Key findings

On 31 Aug, Sino Gas granted 200mn options to certain individuals, with two directors receiving 40mn. The strike price is HK\$0.341, which is in the money at the counter's last price of HK\$0.38. Management thinks as per the NDRC's announced new pricing policy for CNG on 1 Jun 2010, the price performance of CNG will be strong, which has already gone up by 30% since June. In 1H10, Sino Gas made a loss of HK0.23 cents a share but the picture is improving.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

The principal activity of Sino Gas is investment holding and through its subsidiaries is engaged in the operation of CNG and LPG refuelling stations in the PRC.

Closing price on 2 Nov \$0.38

Improving financial performance

① 200mn options issuance with negative earnings

On 31 Aug, Sino Gas granted 200mn options to certain individuals, with two directors receiving 40mn. The strike price is HK\$0.341, which is in the money at the counter's last price of HK\$0.38. The rights can be exercised from now till 30 Aug 2020. No profit or other restriction is on the instruments. Together with total options outstanding at the end of 1H10 of 144mn and none exercised till now, total options outstanding came to 344mn, i.e. ~16.5% of total issued shares.

② Share issuance of 335mn to pay debt

Sino gas on 12 Apr 2010 issued 335mn shares with net proceeds of HK\$126.3mn to pay off debt according to the company. According to our calculation, net D/E ratio stood at 23% and 28% in FY08 and FY09 respectively. Total number of shares became 2,142.36mn at the end of 1H10 compared to 1,807.35mn at the end of 2009.

③ Loss making picture improving

In 1H10 Sino Gas made a loss of HK0.23 cents a share, better than the loss of HK0.33 cents a share in 1H09. The yearly pattern looks better as it improved from FY07's loss of 11.18 HK cents to a loss of HK0.28 cents in FY09.

④ Management upbeat towards next 2 years CNG business

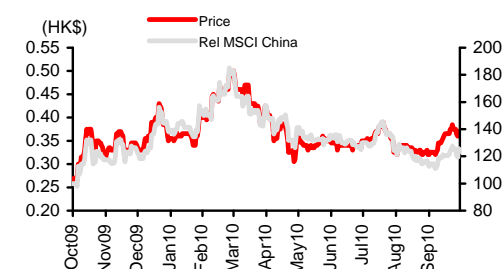
Management thinks as per the NDRC's announced new pricing policy for CNG on 1 Jun 2010, the price performance of CNG will be strong, which has already gone up by 30% since June. Sino Gas is also looking to expand its CNG station network as gas is a preferred energy source of the PRC government.

Key financials

| | 2007 | 2008 | 2009 | Guided |
|---------------------|---------|--------|--------|--------|
| Revenue | 170 | 332 | 614 | ↑ |
| Reported net profit | -183 | -11 | -5 | ↑ |
| Reported EPS | -11.180 | -0.590 | -0.280 | ↑ |
| Rep EPS growth (%) | 6% | -95% | -53% | ↔ |
| Rep P/E (x) | n.a. | n.a. | n.a. | ↔ |
| Price/book (x) | 1.3 | 0.5 | 1.3 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | -43% | -2% | -1% | ↑ |
| Net debt/equity (%) | 9% | 23% | 28% | ↑ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|--|------|-------|-----------|
| Absolute (LC\$) | 15.4 | 5.6 | (7.4) |
| Absolute (US\$) | 15.5 | 5.8 | (7.3) |
| Relative to Index | 9.1 | (4.2) | (17.9) |
| Market cap (US\$m) | | | 103.6 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 0.50/0.29 |
| 3-mth avg daily turnover (US\$m) | | | 0.192 |
| Major shareholders | | | |
| Innovation Assets Limited | | | 57.0% |
| Aviation Industry Corporation of China | | | 30.9% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|----------------|----------------|---------------|---------------|
| Revenue | 161 | 170 | 332 | 614 |
| COS | -118 | -148 | -266 | -475 |
| Gross Profit | 42 | 22 | 66 | 139 |
| EBITDA | 42 | -40 | 23 | 70 |
| Other income | 45 | 9 | 43 | 19 |
| SG&A | -48 | -77 | -107 | -119 |
| EBIT | 37 | -50 | 1 | 38 |
| Interest income | 2 | 5 | 1 | 0 |
| Reported OP | 39 | -46 | 2 | 39 |
| Finance cost | -3 | -12 | -11 | -12 |
| Others | -212 | -127 | -10 | 4 |
| Profit before tax | -176 | -184 | -19 | 31 |
| Income tax | -8 | -1 | -3 | -14 |
| Net Profit | -184 | -186 | -23 | 17 |
| Minority Interest | 52 | 2 | 12 | -22 |
| Net Profit to equity holders | -133 | -183 | -11 | -5 |
| Year-end shares | 1,453 | 1,752 | 1,807 | 1,807 |
| Basic EPS (HK cnets) | -10.510 | -11.180 | -0.590 | -0.280 |
| FD EPS (HK cents) | -10.510 | -11.180 | -0.590 | -0.280 |
| BPS (HK\$) | 0.290 | 0.246 | 0.252 | 0.258 |
| DPS (HK\$) | 0.000 | 0.000 | 0.000 | 0.000 |

| Operating Analysis | 2006A | 2007A | 2008A | 2009A |
|---------------------|-------|-------|-------|-------|
| Sales of Gas | | | | |
| Sales Volume | | | | |
| CNG (mn m3) | NA | NA | 63 | 108 |
| LPG (000' tons) | NA | NA | 25 | 33 |

| Growth Analysis | 2006A | 2007A | 2008A | 2009A |
|----------------------------|-------|-------|-------|-------|
| Revenue | -6% | 5% | 96% | 85% |
| Gross Profit | -26% | -49% | 207% | 111% |
| EBIT | 11% | -236% | -102% | 3393% |
| Net Profit to shareholders | -17% | 38% | -94% | -52% |
| P&L Analysis | 2006A | 2007A | 2008A | 2009A |
| GPM | 26% | 13% | 20% | 23% |
| EBITDA Margin | 26% | -24% | 7% | 11% |
| EBIT Margin | 23% | -30% | 0% | 6% |
| NPM | -83% | -108% | -3% | -1% |

Source: Company data

| Balance Sheet (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|------------|------------|------------|
| Cash and Equivalent | 60 | 135 | 75 | 119 |
| Account Receivable | 37 | 16 | 21 | 12 |
| Inventories | 12 | 6 | 12 | 9 |
| Others | 51 | 86 | 33 | 57 |
| Total current assets | 160 | 243 | 141 | 197 |
| PP&E | 190 | 320 | 369 | 427 |
| Intangible assets | 211 | 144 | 146 | 168 |
| Investment in associates and JCEs | 17 | 10 | 12 | 15 |
| Others | 2 | 5 | 66 | 52 |
| Total non-current assets | 420 | 479 | 593 | 662 |
| Total Assets | 580 | 722 | 734 | 859 |
| ST debt | 53 | 73 | 152 | 162 |
| Account Payable | 15 | 18 | 14 | 12 |
| Others | 38 | 58 | 48 | 58 |
| Total current liabilities | 106 | 149 | 213 | 233 |
| LT debt | 30 | 103 | 29 | 88 |
| Others | 0 | 0 | 0 | 0 |
| Total LT liabilities | 31 | 103 | 29 | 88 |
| Total Liabilities | 136 | 251 | 242 | 321 |
| Equity Capital | 291 | 350 | 361 | 361 |
| Reserves | 130 | 80 | 94 | 105 |
| Shareholder's equity | 421 | 430 | 455 | 466 |
| Minority interest | 22 | 40 | 37 | 72 |
| Total Liabilities and Equity | 580 | 722 | 734 | 859 |

| Cash Flow Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-----------------------------------|------------|-------------|-------------|------------|
| EBIT | 37 | -50 | 1 | 38 |
| Depreciation and Amortization | 4 | 10 | 22 | 32 |
| Change of NWC | -92 | -15 | 46 | 17 |
| Tax Paid | -3 | 0 | -2 | -10 |
| Interest paid | -3 | -6 | -6 | -10 |
| Others | -28 | 27 | -16 | 9 |
| Operating Cash Flow | -83 | -36 | 46 | 76 |
| CAPEX | -97 | -129 | -115 | -71 |
| Acquisitions | -1 | 15 | 0 | -17 |
| Interest received | 2 | 5 | 1 | 0 |
| Others | 0 | -26 | -2 | -3 |
| Investing Cash Flow | -96 | -135 | -117 | -91 |
| Net borrowings | 41 | 97 | -6 | 66 |
| Equity Issue | 139 | 147 | 0 | 0 |
| From option and convertible notes | 12 | 6 | 11 | 12 |
| Dividend | 0 | 0 | 0 | -2 |
| Others | 13 | -4 | 3 | -18 |
| Financing Cash Flow | 205 | 245 | 8 | 59 |
| FX Effect | 1 | 1 | 3 | 0 |
| Net Cash Flow Change | 26 | 74 | -63 | 44 |
| Year-end Cash Flow | 60 | 135 | 75 | 119 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|-------|-------|-------|-------|
| ROE | -32% | -43% | -2% | -1% |
| ROA | -23% | -28% | -1% | -1% |
| ROIC | -30% | -39% | -2% | -1% |
| Net gearing | 6% | 9% | 23% | 28% |
| Debt/equity | 20% | 41% | 40% | 54% |
| Debt/capital | 19% | 37% | 32% | 42% |
| Interest coverage (X) | 12.1 | -3.4 | 2.1 | 6.1 |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data

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Key findings

In 1H10, COG recorded 41% y-y gas sales volume growth, resulting in growth of 38% y-y in revenue and 2% in EPS. COG expects to use CBM for CNG production at the end of 2010. Once the CBM schedule is confirmed, two LNG factories can be put into construction. First phase of Taizhou-Jiangyan-Dainan branch line will also be ready by the end of 2010. COG targets to explore the machinery business by purchasing 5 sets of equipment and signing a cooperation agreement with Jinan Diesel (owned by CNPC).

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

COG engages principally in the operation of piped city gas business, pipeline design and construction, as well as the transportation, distribution and sales of CNG and LPG.

Closing price on 2 Nov \$1.01

Exploring in machinery business

① Acquisition in Jiangxi and exploring machinery business

In July, COG purchased a 51% share in a JV (total RMB100mn registered capital) with Pingxiang Coal Gas Company for the development of the city's economic zone in Pingxiang. Pingxiang is located in Jiangxi (120,000 population and 260 industrial users) and is currently experiencing severe NG shortages. COG also targets to explore the machinery business by purchasing five sets of equipment and signing a cooperation agreement with Jinan Diesel (owned by CNPC) in October.

② Coalbed methane operating in end 2010

COG expects to use CBM for the CNG production at the end of 2010 and it will continue to operate with PetroChina CBM Company. Once the CBM schedule is confirmed, two LNG factories can then be put into construction.

③ Sales volume of gas up 41% in 1H10 but profit up by 10%

In 1H10 COG's gas sales totalled 662mn m3, 41% up y-y from 1H09's 471mn m3. The sales were mainly from C&I (72%), with the remaining from household (11%) and CNG stations (16%). However, the magnitude of the cost increase outweighed the revenue growth, as well as the 500mn share issuance in Jan, resulting in a 10% and 2% increase only in profit and EPS, respectively.

④ Four projects to be finalised for commercialization

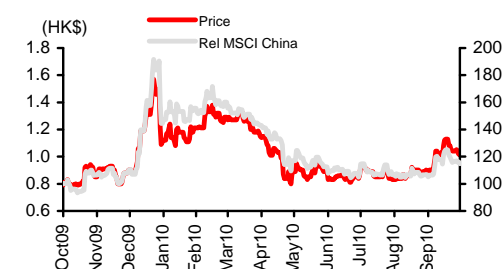
COG expects the first phase of Taizhou-Jiangyan-Dainan branch line, Anyi-Nanchang and Nantong Rugao-Haian branch lines will be ready by the end of FY10. Additionally, COG will seek to secure the construction of Yuedong branch line in order to facilitate its Chaozhou project.

Key financials

| | 2007 | 2008 | 2009 | Guided |
|---------------------|----------|----------|----------|--------|
| Revenue | 677 | 1,721 | 1,471 | ↔ |
| Reported net profit | 73 | 132 | 73 | ↔ |
| Reported EPS | 0.021 | 0.030 | 0.017 | ↔ |
| Rep EPS growth (%) | -32% | 43% | -41% | ↔ |
| Rep P/E (x) | 35.8 | 6.6 | 49.7 | ↔ |
| Price/book (x) | 2.3 | 0.5 | 2.6 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | 9% | 9% | 5% | ↓ |
| Net debt/equity (%) | net cash | net cash | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|------|-------|-----------|
| Absolute (LC\$) | 12.2 | 9.8 | (12.2) |
| Absolute (US\$) | 12.4 | 10.0 | (12.0) |
| Relative to Index | 5.9 | (0.1) | (22.6) |
| Market cap (US\$m) | | | 645 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 1.57/0.77 |
| 3-mth avg daily turnover (US\$m) | | | 2.10 |
| Major shareholders | | | |
| Guan Yijun | | | 22.2% |
| Lo Chung | | | 5.9% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Revenue | 370 | 677 | 1,721 | 1,471 |
| COS | -290 | -508 | -1,313 | -1,119 |
| Gross Profit | 80 | 170 | 408 | 352 |
| EBITDA | 90 | 153 | 400 | 276 |
| Other income | 47 | 54 | 45 | 18 |
| SG&A | -46 | -76 | -131 | -127 |
| EBIT | 79 | 125 | 319 | 229 |
| Interest income | 1 | 22 | 3 | 14 |
| Reported OP | 81 | 148 | 322 | 243 |
| Finance cost | -9 | -20 | -17 | -24 |
| Others | 2 | 1 | 0 | 2 |
| Profit before tax | 74 | 129 | 305 | 221 |
| Income tax | -7 | -16 | -53 | -34 |
| Net Profit | 66 | 114 | 253 | 187 |
| Profit from discontinued operations | 2 | | | |
| Minority Interest | -11 | -41 | -121 | -114 |
| Net Profit to equity holders | 57 | 73 | 132 | 73 |
| Year-end shares | 2,520 | 3,817 | 4,458 | 4,458 |
| Basic EPS (HK\$) | 0.030 | 0.021 | 0.030 | 0.017 |
| FD EPS (HK\$) | NA | 0.019 | 0.030 | NA |
| BPS (HK\$) | 0.124 | 0.329 | 0.366 | 0.336 |
| DPS (HK\$) | 0.000 | 0.000 | 0.000 | 0.000 |

| Operating Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------------|------------|------------|--------------|--------------|
| Sales of NG | | | | |
| Sales Volume (mn m3) | 480 | 689 | 1,224 | 1,789 |
| Gas sales | 480 | 578 | 815 | 965 |
| Residential | 43 | 40 | 76 | 84 |
| Commercial | | | 11 | 25 |
| Industrial | 226 | 329 | 514 | 628 |
| CNG | 43 | 64 | 145 | 146 |
| LNG | | | 69 | 82 |
| Government and Utility | 168 | 145 | | |
| Transmission | 0 | 111 | 363 | 762 |
| Logistics | 0 | 0 | 46 | 62 |
| Revenue (HK\$ mn) | 370 | 677 | 1,408 | 1,506 |

| Growth Analysis | 2006A | 2007A | 2008A | 2009A |
|----------------------------|-------|-------|-------|-------|
| Revenue | 84% | 83% | 154% | -15% |
| Gross Profit | 29% | 113% | 141% | -14% |
| EBIT | 5836% | 58% | 154% | -28% |
| Net Profit to shareholders | n.a. | 27% | 82% | -45% |
| P&L Analysis | 2006A | 2007A | 2008A | 2009A |
| EBITDA Margin | 24% | 23% | 23% | 19% |
| EBIT Margin | 21% | 19% | 19% | 16% |
| NPM | 16% | 11% | 8% | 5% |

Source: Company data

| Balance Sheet (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|--------------|--------------|--------------|
| Cash and Equivalent | 165 | 839 | 1,070 | 731 |
| Account Receivable | 97 | 202 | 263 | 326 |
| Inventories | 8 | 27 | 54 | 46 |
| Others | 36 | 17 | 58 | 20 |
| Total current assets | 306 | 1,086 | 1,444 | 1,123 |
| PP&E | 109 | 514 | 1,214 | 1,004 |
| Intangible assets | 62 | 586 | 704 | 665 |
| Investment in associates and JCEs | 14 | 0 | 2 | 0 |
| Others | 1 | 2 | 0 | 0 |
| Total non-current assets | 186 | 1,101 | 1,921 | 1,670 |
| Total Assets | 493 | 2,186 | 3,365 | 2,793 |
| ST debt | 14 | 80 | 339 | 241 |
| Account Payable | 96 | 316 | 727 | 555 |
| Others | 9 | 18 | 14 | 23 |
| Total current liabilities | 119 | 414 | 1,080 | 818 |
| LT debt | 39 | 224 | 52 | 65 |
| Others | 3 | 5 | 10 | 6 |
| Total LT liabilities | 41 | 230 | 62 | 71 |
| Total Liabilities | 160 | 644 | 1,142 | 889 |
| Equity Capital | 25 | 38 | 45 | 45 |
| Reserves | 286 | 1,217 | 1,587 | 1,454 |
| Shareholder's equity | 311 | 1,255 | 1,632 | 1,499 |
| Minority interest | 21 | 287 | 591 | 405 |
| Total Liabilities and Equity | 493 | 2,186 | 3,365 | 2,793 |

| Cash Flow Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------|------------|-------------|-------------|-------------|
| EBIT | 79 | 125 | 319 | 229 |
| Depreciation and Amortization | 10 | 28 | 79 | 46 |
| Change of NWC | 62 | 81 | 0 | 0 |
| Tax Paid | 1 | -8 | -56 | -31 |
| Interest paid | -9 | -12 | -17 | -21 |
| Others | -12 | 25 | 231 | 136 |
| Operating Cash Flow | 131 | 238 | 556 | 359 |
| CAPEX | -21 | -158 | -344 | -449 |
| Acquisitions | -41 | -481 | 0 | -91 |
| Interest received | 1 | 22 | 3 | 14 |
| Others | 32 | 105 | 92 | -15 |
| Investing Cash Flow | -28 | -512 | -248 | -541 |
| Net borrowings | -19 | -21 | 85 | 125 |
| Equity Issue | 65 | 842 | 0 | 0 |
| Issue of convertible notes | -4 | 156 | 0 | 0 |
| Interest and dividend | -13 | -21 | -37 | -47 |
| Others | 5 | -10 | 0 | -1 |
| Financing Cash Flow | 34 | 946 | 49 | 76 |
| FX Effect | 2 | 14 | -1 | 19 |
| Net Cash Flow Change | 137 | 672 | 356 | -106 |
| Year-end Cash Flow | 165 | 839 | 1,070 | 731 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|----------|----------|----------|----------|
| ROE | 18% | 9% | 9% | 5% |
| ROA | 12% | 5% | 5% | 2% |
| ROIC | 29% | 10% | 14% | 7% |
| Net gearing | net cash | net cash | net cash | net cash |
| Debt/equity | 17% | 24% | 24% | 20% |
| Debt/capital | 27% | 42% | 41% | 28% |
| Interest coverage (X) | 9.9 | 7.7 | 23.9 | 11.3 |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data



Key findings

On 4 November, the company announced it had entered into a subscription agreement with investors. It will issue ~327.8mn new shares (16.49% of its enlarged share capital) through top-up placing and subscription for new shares at a price of HK\$1.4, raising proceeds of ~HK\$458.9mn. Funds raised will be used for the acquisition of potential oil & gas projects, including the remaining 30% ownership in the Utah Gas and Oil Field, as well as exploitation of new wells and for working capital.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

Raising funds for oil & gas projects in the US

① Investment in US oil & gas projects

On 25 January, 2010, the company announced plans to acquire a 100% exploitation interest for the Utah Natural Gas & Oilfield project in the US. The consideration for a 70% exploitation interest in Phase I of the acquisition was to be settled in cash (US\$50mn) and new shares in POI (US\$150mn). The company had an option to acquire the remaining 30% at US\$25mn. Per the company, the Utah Gas and Oil Field has started production and has been generating revenue since 10 October, 2010. According to the company, it is now in the process of negotiating a new acquisition involving an oil & gas project in Kazakhstan.

② Raising funds for Utah Gas and Oil field

On 4 November, 2010, the company announced it had entered into a subscription agreement with more than six investors, including the British Rowland Family, Senrigan Capital Group Ltd., Wellchamp Capital Ltd., and other institutional investors. It will issue an aggregate of ~327.8mn new shares (representing 16.49% of the enlarged share capital) through both top-up placing and subscription for new shares at a price of HK\$1.4, raising total proceeds of ~HK\$458.9mn. According to the company, funds raised will be used for the acquisition of potential oil & gas projects, including the remaining 30% ownership in the Utah Gas and Oil Field, and for the exploitation of new wells of the Utah Gas and Oil Field and as working capital.

③ 1H10 profit of HK\$617mn driven by fair value gain

In 1H10, turnover increased to HK\$286.2mn, ie, y-y growth of 21%. Net profit totalled HK\$617mn, driven by a fair value gain on Utah Gas and Oil Field's identifiable net assets over costs of HK\$741.1mn. Excluding this gain, the company recorded a loss of HK\$124.1mn, up from a loss of HK\$11.4mn in the prior-year period.

NUGGETS

Non-rated ideas from Nomura

Company description

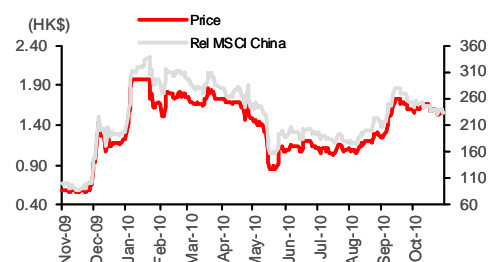
POI is an investment holding company. It is principally engaged in energy and recycling businesses.

Key financials

| | 2007 | 2008 | 2009 | Guided |
|---------------------|--------|--------|----------|--------|
| Revenue | 65 | 79 | 196 | ↑ |
| Reported net profit | -53 | -38 | -567 | ↔ |
| Reported EPS | -0.200 | -0.085 | -0.876 | ↔ |
| Rep EPS growth (%) | -74% | -58% | 931% | ↔ |
| Rep P/E (x) | -12.0 | -4.5 | -1.4 | ↑ |
| Price/book (x) | 21.5 | 3.3 | 16.7 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | -23% | -8% | -135% | ↓ |
| Net debt/equity (%) | 11% | 9% | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|-----------------------------------|-------|------|-----------|
| Absolute (LC\$) | (1.9) | 44.4 | 5.4 |
| Absolute (US\$) | (1.8) | 44.7 | 5.6 |
| Relative to Index | (8.2) | 34.6 | (5.0) |
| Market cap (US\$mn) | | | 333.9 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 1.98/0.56 |
| 3-mth avg daily turnover (US\$mn) | | | 1.63 |
| Major shareholders | | | |
| Wong Yuk Kwan | | | 42.9% |
| Zhang Jing Yuan | | | 6.8% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|---------------|---------------|---------------|---------------|
| Revenue | 75 | 65 | 79 | 196 |
| COS | (58) | (51) | (51) | (175) |
| Gross Profit | 17 | 14 | 28 | 20 |
| EBITDA | 0 | (29) | (15) | (30) |
| Other income | 7 | 4 | 12 | 24 |
| SG&A | (29) | (51) | (61) | (84) |
| EBIT | (5) | (34) | (21) | (39) |
| Interest income | 2 | 1 | 0 | 0 |
| Reported OP | (2) | (33) | (21) | (39) |
| Finance cost | (6) | (7) | (6) | (6) |
| Others | (73) | 18 | 8 | (884) |
| Profit before tax | (84) | (54) | (40) | (968) |
| Income tax | (0) | (1) | (1) | (0) |
| Net Profit | (84) | (55) | (41) | (968) |
| Profit from discontinued operations | - | - | - | - |
| Minority Interest | (1) | 2 | 3 | 401 |
| Net Profit to equity holders | (85) | (53) | (38) | (567) |
| Year-end shares | 2,520 | 3,817 | 4,458 | 4,458 |
| Basic EPS (HK\$) | (0.78) | (0.20) | (0.09) | (0.88) |
| FD EPS (HK\$) | NA | NA | (0.09) | (0.88) |
| BPS (HK\$) | 0.011 | 0.112 | 0.115 | 0.074 |
| DPS (HK\$) | - | - | - | - |

| Balance Sheet (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|------------|------------|------------|
| Cash and Equivalent | 2 | 11 | 16 | 224 |
| Account Receivable | 18 | 22 | 10 | 6 |
| Inventories | - | - | 9 | 9 |
| Others | 15 | 1 | 17 | 48 |
| Total current assets | 35 | 33 | 52 | 287 |
| PP&E | 96 | 96 | 165 | 64 |
| Intangible assets | - | 18 | 36 | 123 |
| Investment in associates and JCEs | 19 | 399 | 421 | - |
| Others | 1 | 1 | - | - |
| Total non-current assets | 115 | 514 | 622 | 187 |
| Total Assets | 150 | 547 | 674 | 474 |
| ST debt | 86 | 58 | 8 | - |
| Account Payable | 14 | 18 | 9 | 6 |
| Others | 18 | 44 | 42 | 57 |
| Total current liabilities | 118 | 120 | 59 | 63 |
| LT debt | - | - | 52 | - |
| Others | - | - | 41 | 66 |
| Total LT liabilities | - | - | 93 | 66 |
| Total Liabilities | 118 | 120 | 152 | 129 |
| Equity Capital | 54 | 191 | 46 | 116 |
| Reserves | (26) | 235 | 467 | 213 |
| Shareholder's equity | 28 | 426 | 513 | 329 |
| Minority interest | 4 | 2 | 9 | 16 |
| Total Liabilities and Equity | 150 | 547 | 674 | 474 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|-------|-------|-------|----------|
| ROE | -300% | -23% | -8% | -135% |
| ROA | -56% | -15% | -6% | -99% |
| ROIC | -76% | -11% | -7% | -542% |
| Net gearing | 297% | 11% | 9% | net cash |
| Debt/equity | 303% | 14% | 12% | 0% |
| Debt/capital | 76% | 12% | 11% | 0% |
| Interest coverage (X) | 0.0 | -4.2 | -2.3 | -5.3 |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data



Key findings

SOG used HK\$2.34bn to acquire CBM field in Shanxi and Shaanxi. Total reserves of Sanjiao Block are estimated to exceed 36.8bcm. There is a pipeline under construction to support the field, with more than 1bcm per annum of capacity expected to be finished in 1Q11. On 12 Oct, SOG said it found a 500mn m3 high-yield shallow gas reserve in Shaanxi. The future of SOG is now heavily leveraged on CBM development.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

SOG is engaged principally in the exploitation, development and operation of crude oil and natural gas fields in the PRC and the US. It bought a CBM field in 2010.

Closing price on 2 Nov \$0.49

Leveraged on CBM development

① Shaanxi 500mn m3 gas reserve discovered

On 12 Oct, SOG said it found a 500mn m3 high-yield shallow gas reserve in Shaanxi. SOG's oil and gas technical team indicated that daily open flow of each gas well would be more than 10,000 m3. It is expected that daily production of each well will be more than 3,000 m3 when the production becomes stable.

② HK\$2.34bn acquired CBM field in Shanxi and Shaanxi

The company acquired a 70% interest in CBM field, Sanjiao Block, in Shanxi and Shaanxi, at a consideration of HK\$2.34bn, comprised of HK\$780m cash, 1.56bn shares (i.e. HK\$780mn) and convertible bond of HK\$780mn. In addition, another HK\$156mn will be added if the field's entire reserve is proved to be more than 28.7bcm within one year. Exploration period ends on 30 Jun 2012. Total reserve of Sanjiao Block is estimated to exceed 36.8bcm.

③ Pipeline at Sanjiao Block finishing in 1Q11

Construction of provincial pipeline in Shaanxi and Shanxi which is owned by a PRC local enterprise is expected to be completed in 1Q11. Capacity of the pipeline is no less than 1bcm per annum dedicated to SOG by the end of 2012. Apart from the above pipeline, SOG is also aiming to sell the CBM as CNG or LNG.

④ Total of four oil blocks in PRC and US

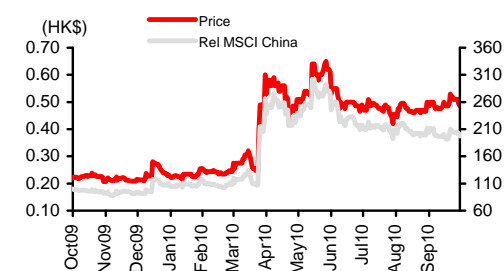
The company also has four oil blocks located in the PRC and the US. Liuluoyu and Yanjiawan are located in PRC having 155 wells yielding 4,300 barrels a month. Grassy Trails and Squaw Canyon in the US have total reserves of 1.87mn barrels (~0.25mn tons). Grassy Trails is having trouble commencing due to environmental issues and no public disclosure is made for the actual production volume from the US.

Key financials

| | FY07 | FY08 | FY09 | Guided |
|---------------------|----------|----------|--------|--------|
| Revenue | 31 | 4 | 15 | ↔ |
| Reported net profit | 1 | -139 | -18 | ↔ |
| Reported EPS | -0.190 | -3.310 | -0.430 | ↔ |
| Rep EPS growth (%) | -93% | 1642% | -87% | ↔ |
| Rep P/E (x) | n.a. | n.a. | n.a. | ↔ |
| Price/book (x) | 3.8 | 3.1 | 6.3 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | 1% | -71% | -13% | ↑ |
| Net debt/equity (%) | net cash | net cash | 4% | ↑ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|-------|-------|-----------|
| Absolute (LC\$) | (2.0) | - | (15.5) |
| Absolute (US\$) | (1.9) | 0.2 | (15.4) |
| Relative to Index | (8.3) | (9.9) | (26.0) |
| Market cap (US\$m) | | | 423.2 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 0.65/0.21 |
| 3-mth avg daily turnover (US\$m) | | | 1.17 |
| Major shareholders | | | |
| Xing Xiao Jing | | | 12.5% |
| Och Daniel Saul | | | 9.7% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$m) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|---------------|---------------|---------------|---------------|
| Revenue | 27 | 31 | 4 | 15 |
| COS | -30 | -34 | -6 | -20 |
| Gross Profit | -3 | -3 | -2 | -5 |
| EBITDA | -3 | 6 | -18 | -16 |
| Other income | 0 | 5 | 1 | 3 |
| SG&A | -51 | -48 | -35 | -24 |
| EBIT | -54 | -41 | -35 | -25 |
| Interest income | 0 | 5 | 1 | 0 |
| Reported OP | -53 | -36 | -34 | -25 |
| Finance cost | -1 | 0 | 0 | -2 |
| Others | 0 | 0 | -4 | -6 |
| Profit before tax | -54 | -36 | -39 | -33 |
| Income tax | -1 | -1 | 0 | 0 |
| Net Profit | -55 | -37 | -39 | -33 |
| Profit from discontinued operations | -51 | 39 | -100 | 14 |
| Minority Interest | -20 | 0 | 0 | 0 |
| Net Profit to equity holders | -125 | 1 | -139 | -18 |
| Year-end shares | 0 | 4,225 | 4,227 | 4,386 |
| Basic EPS (HK\$) | -2.690 | -0.190 | -3.310 | -0.430 |
| FD EPS (HK\$) | -2.690 | -0.190 | -3.310 | -0.430 |
| BPS (HK\$) | NA | 0.062 | 0.031 | 0.034 |
| DPS (HK\$) | NA | 0.000 | 0.000 | 0.000 |

| Growth Analysis | 2006A | 2007A | 2008A | 2009A |
|----------------------------|-------|-------|---------|-------|
| Revenue | -60% | 14% | -87% | 260% |
| Gross Profit | -73% | 4% | -29% | 166% |
| EBIT | -77% | -23% | -14% | -28% |
| Net Profit to shareholders | -52% | -101% | -10119% | -87% |
| P&L Analysis | 2006A | 2007A | 2008A | 2009A |
| GPM | -9% | -9% | -46% | -34% |
| EBITDA Margin | -10% | 19% | -439% | -104% |
| EBIT Margin | -195% | -130% | -835% | -168% |
| NPM | -456% | 4% | -3297% | -121% |

Source: Company data

| Balance Sheet (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|------------|------------|------------|
| Cash and Equivalent | 51 | 111 | 20 | 11 |
| Account Receivable | 17 | 5 | 17 | 7 |
| Inventories | 1 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 |
| Total current assets | 69 | 117 | 37 | 18 |
| PP&E | 555 | 144 | 42 | 116 |
| Intangible assets | 4 | 47 | 50 | 100 |
| Investment in associates and JCEs | 0 | 0 | 15 | 10 |
| Others | -1 | 0 | 6 | 3 |
| Total non-current assets | 558 | 191 | 113 | 228 |
| Total Assets | 628 | 308 | 150 | 246 |
| ST debt | 303 | 0 | 0 | 0 |
| Account Payable | 61 | 47 | 17 | 22 |
| Others | 0 | 1 | 1 | 0 |
| Total current liabilities | 364 | 47 | 18 | 22 |
| LT debt | 160 | 0 | 0 | 17 |
| Others | 0 | 0 | 0 | 59 |
| Total LT liabilities | 160 | 0 | 0 | 76 |
| Total Liabilities | 524 | 47 | 18 | 98 |
| Equity Capital | 36 | 42 | 42 | 44 |
| Reserves | 68 | 219 | 90 | 104 |
| Shareholder's equity | 104 | 261 | 132 | 148 |
| Minority interest | 0 | 0 | 0 | 0 |
| Total Liabilities and Equity | 628 | 308 | 150 | 246 |

| Cash Flow Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-----------------------------------|-----------|------------|------------|------------|
| EBIT | -54 | -41 | -35 | -25 |
| Depreciation and Amortization | 51 | 47 | 17 | 10 |
| Change of NWC | -13 | -27 | 4 | -2 |
| Tax Paid | -1 | -1 | -2 | -1 |
| Interest paid | -3 | -3 | 0 | 0 |
| Others | 29 | 17 | 3 | 2 |
| Operating Cash Flow | 10 | -8 | -14 | -16 |
| CAPEX | -5 | -25 | -21 | -4 |
| Acquisitions | 0 | -38 | -6 | -73 |
| Interest received | 0 | 5 | 1 | 0 |
| Others | 1 | -2 | -18 | -12 |
| Investing Cash Flow | -4 | -61 | -44 | -88 |
| Net borrowings | 9 | -23 | -33 | 89 |
| Equity Issue | 58 | 120 | 0 | 0 |
| From option and convertible notes | 5 | 22 | 0 | 7 |
| Dividend | 0 | 0 | 0 | 0 |
| Others | -29 | 10 | -1 | 1 |
| Financing Cash Flow | 43 | 128 | -33 | 96 |
| FX Effect | 0 | 0 | 0 | 0 |
| Net Cash Flow Change | 48 | 60 | -92 | -9 |
| Year-end Cash Flow | 51 | 111 | 20 | 11 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|-------|----------|----------|-------|
| ROE | -120% | 1% | -71% | -13% |
| ROA | -20% | 0% | -61% | -9% |
| ROIC | -24% | 1% | -123% | -12% |
| Net gearing | 396% | net cash | net cash | 4% |
| Debt/equity | 445% | 0% | 0% | 11% |
| Debt/capital | 90% | 0% | 0% | 11% |
| Interest coverage (X) | -5.1 | 35.2 | n.a. | -8.9 |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data



Key findings

SGE owns and controls more than 30% of the natural gas market in Hebei on a consumption basis. Wind power business in 1H10 exhibited strong performance, contributing 37% of total profit, vs 23.2% in FY09. Net margin in 1H10 also grew by 15pps, to 37% compared to 22% in 1H09. SGE passed through the price hike on 1 June 2010, to wholesale, retail and CNG customers.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

SGE is principally engaged in the development and management of wind power generation, sale of natural gas and gas appliances, and connection and construction of natural gas pipelines.

Closing price on 2 Nov \$2.58

Gas as core, wind gives wings

① Gas and wind player backed by Hebei government

SGE owns and operates in Hebei 1 long-distance transmission pipeline, 4 branch pipelines, 4 city gas pipeline networks, 9 natural gas distribution stations and 1 central CNG station, covering 23 cities and counties, controlling more than 30% of the natural gas market in Hebei on a consumption basis. For wind power, consolidated installed capacity and capacity under construction were 606.2MW and 347.8 MW respectively.

② Jun gas price hike passed onto all C&I customers

The benchmark ex-plant prices for industrial, commercial and residential sectors increased by 30.6%, 27.7% and 16.1% respectively. SGE has applied new prices following new pricing scheme on 1 June 2010, to wholesale, retail and CNG customers. For the residential sector, SGE still awaits local government to announce hearing for residential gas price lift.

③ Wind's strong 1H10 performance

SGE's gross margins reduced from 31% in FY08 to 28% in FY09, due to the 2pps decline in wind power's gross margin from 57% to 55%. However, wind power business in 1H10 exhibited strong performance contributing 37% of profit, vs 23% in FY09. The segment's net margin in 1H10 also grew by 15pps, to 37%, compared to 22% in 1H09.

④ Use of IPO proceeds mainly for wind segment

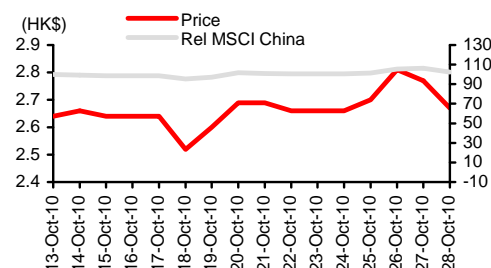
81% of the net IPO proceeds (~HK\$1,917.8mn) will be used for wind power projects in PRC and 9% (~HK\$473.5mn) will be used for investment in the development of natural gas projects while the rest goes to working capital.

Key financials

| | 2007 | 2008 | 2009 | Guided |
|---------------------|------|-------|-------|--------|
| Revenue | 629 | 1,019 | 1,517 | ↑ |
| Reported net profit | 25 | 87 | 166 | ↑ |
| Reported EPS | n.a. | n.a. | n.a. | ↔ |
| Rep EPS growth (%) | n.a. | n.a. | n.a. | ↔ |
| Rep P/E (x) | n.a. | n.a. | n.a. | ↔ |
| Price/book (x) | n.a. | n.a. | n.a. | ↔ |
| Dividend yield (%) | n.a. | n.a. | n.a. | ↔ |
| ROE (%) | 5% | 11% | 14% | ↑ |
| Net debt/equity (%) | 148% | 200% | 201% | ↑ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|----|----|-----------|
| Absolute (LC\$) | na | na | na |
| Absolute (US\$) | na | na | na |
| Relative to Index | na | na | na |
| Market cap (US\$m) | | | 453.4 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 2.81/2.52 |
| 3-mth avg daily turnover (US\$m) | | | 9.83 |
| Major shareholders | | | |
| Morgan Stanley | | | 17.4% |
| JPMorgan Chase & Co. | | | 13.3% |

Source: Bloomberg

Financial statements

| Income Statement (RMBmn) | 2007A | 2008A | 2009A |
|-------------------------------------|-------------|-------------|-------------|
| Revenue | 629 | 1,019 | 1,517 |
| COGS | -527 | -768 | -1,091 |
| Gross Profit | 102 | 251 | 426 |
| EBITDA | 130 | 285 | 557 |
| Other income | -9 | -8 | -7 |
| SG&A | -35 | -55 | -70 |
| EBIT | 76 | 214 | 406 |
| Interest income | 1 | 1 | 2 |
| Reported OP | 78 | 216 | 408 |
| Finance cost | -31 | -52 | -104 |
| Others | -1 | -2 | 2 |
| Profit before tax | 46 | 161 | 306 |
| Income tax | -8 | -10 | -19 |
| Net Profit | 37 | 151 | 287 |
| Minority Interest | -12 | -64 | -121 |
| Net Profit to equity holders | 25 | 87 | 166 |
| Year-end shares | n.a. | n.a. | n.a. |
| Basic EPS (RMB) | n.a. | n.a. | n.a. |
| Recurring EPS (RMB) | n.a. | n.a. | n.a. |
| FD EPS (RMB) | n.a. | n.a. | n.a. |
| BPS (RMB) | n.a. | n.a. | n.a. |
| DPS (RMB) | n.a. | n.a. | n.a. |

| Operating Analysis (RMBmn) | 2007A | 2008A | 2009A |
|--|--------------|--------------|--------------|
| Sales of NG | | | |
| Sales Volume (mn m3) | 394 | 563 | 730 |
| Wholesale | 267 | 380 | 491 |
| Retail | 92 | 140 | 193 |
| Residential | 1 | 2 | 3 |
| Commercial | 1 | 2 | 2 |
| Industrial | 90 | 136 | 189 |
| CNG | 35 | 43 | 46 |
| Avg. Tariff (RMB/m3 VAT incl.) | 1.46 | 1.61 | 1.63 |
| Wholesale | 1.40 | 1.51 | 1.53 |
| Retail | 1.53 | 1.82 | 1.85 |
| CNG | 1.72 | 1.75 | 1.85 |
| Connection fees and others | 16 | 27 | 61 |
| Revenue (RMB mn) | 591 | 932 | 1,253 |
| Wind Power | | | |
| Total Installed capacity (MW) | 60.6 | 233.9 | 604.7 |
| Consolidated installed capacity (MW) | 60.6 | 233.6 | 406.7 |
| Attributable installed capacity (MW) | 60.6 | 160.1 | 381.1 |
| Consolidated gross power generation (MWh) | 81,357 | 221,464 | 634,698 |
| Average Utilization hours (MWh) | 2,045 | 2,130 | 2,276 |
| Consolidated net power delivered (MWh) | 75,753 | 166,639 | 554,841 |
| Avg. On-grid Tariff (RMB/KWH VAT excl.) | 0.587 | 0.576 | 0.558 |
| Revenue (RMB mn) | 38 | 82 | 265 |
| Overall | | | |
| Total Revenue (RMB mn) | 629 | 1,019 | 1,517 |
| Total Gross Profit (RMB mn) | 298.6 | 311.8 | 426.3 |
| GPM (%) | 47% | 31% | 28% |

| Growth Analysis | 2007A | 2008A | 2009A |
|----------------------------|-------|-------|-------|
| Revenue | 18% | 62% | 49% |
| Gross Profit | 24% | 146% | 70% |
| EBIT | 46% | 181% | 89% |
| Net Profit to shareholders | 15% | 241% | 92% |
| P&L Analysis | 2007A | 2008A | 2009A |
| GPM | 35% | 31% | 28% |
| EBITDA Margin | 26% | 28% | 37% |
| EBIT Margin | 22% | 21% | 27% |
| NPM | 15% | 9% | 11% |

Source: Company data

| Balance Sheet (RMBmn) | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|--------------|
| Cash and Equivalent | 82 | 213 | 330 |
| Account Receivable | 27 | 42 | 85 |
| Inventories | 7 | 19 | 22 |
| Others | 42 | 186 | 106 |
| Total current assets | 158 | 460 | 542 |
| PP&E | 1,509 | 3,232 | 4,358 |
| Intangible assets | 13 | 38 | 73 |
| Investment in associates and JCEs | 16 | 96 | 223 |
| Others | 221 | 219 | 588 |
| Total non-current assets | 1,759 | 3,585 | 5,241 |
| Total Assets | 1,917 | 4,046 | 5,783 |
| ST debt | 304 | 377 | 879 |
| Account Payable | 21 | 36 | 440 |
| Others | 214 | 375 | 410 |
| Total current liabilities | 539 | 789 | 1,728 |
| LT debt | 590 | 1,829 | 2,146 |
| Others | 36 | 57 | 32 |
| Total LT liabilities | 626 | 1,886 | 2,177 |
| Total Liabilities | 1,165 | 2,674 | 3,906 |
| Equity Capital | 548 | 995 | 1,344 |
| Reserves | 0 | 0 | 0 |
| Shareholder's equity | 548 | 995 | 1,344 |
| Minority interest | 204 | 396 | 534 |
| Total Liabilities and Equity | 1,917 | 4,066 | 5,783 |

| Cash Flow Statement (RMBmn) | 2007A | 2008A | 2009A |
|------------------------------------|-------------|---------------|---------------|
| EBIT | 46 | 161 | 306 |
| Depreciation and Amortization | 53 | 70 | 149 |
| Change of NWC | -29 | 29 | -43 |
| Tax Paid | -2 | -3 | -12 |
| Interest paid | -35 | -112 | -148 |
| Others | 31 | 54 | 102 |
| Operating Cash Flow | 64 | 199 | 354 |
| CAPEX | -733 | -1,631 | -1,380 |
| Acquisitions | 0 | 0 | -66 |
| Interest received | 1 | 1 | 2 |
| Others | -26 | -238 | 91 |
| Investing Cash Flow | -758 | -1,868 | -1,353 |
| Net borrowings | 414 | 1,312 | 819 |
| Equity Issue | 0 | 0 | 0 |
| Capital contribution from minority | 112 | 128 | 83 |
| Interest and dividend | 0 | 0 | -138 |
| Others | 0 | 360 | 352 |
| Financing Cash Flow | 526 | 1,800 | 1,116 |
| FX Effect | 0 | 0 | 0 |
| Net Cash Flow Change | -168 | 131 | 117 |
| Year-end Cash | 82 | 213 | 330 |

| Other Ratio Analysis | 2007A | 2008A | 2009A |
|-----------------------|-------|-------|-------|
| ROE | 5% | 11% | 14% |
| ROA | 2% | 3% | 3% |
| ROIC | 2% | 3% | 4% |
| Net gearing | 148% | 200% | 201% |
| Debt/equity | 163% | 222% | 225% |
| Debt/capital | 66% | 74% | 75% |
| Interest coverage (X) | 4.2 | 5.4 | 5.4 |
| Dividend payout ratio | 0% | 0% | 0% |

Source: Company data



Key findings

According to the prospectus, the company forecasted FY10F's bottom line will not be less than RMB66.1mn. For the business model, Tian Lun relies on gas connection revenue. In 1H10, around 51% of total revenue, 81% of total gross profit and 71% of the profit were derived from connection fees. Currently, the company is in discussion for 3 projects in Henan and plans to utilize 50.5% of the IPO proceeds for these 3 projects. The company will start trading on 10 November 2010.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

Tian Lun Gas is principally engaged in gas pipeline connection operation and the transportation and sales of pipeline gas in Henan Province.

Closing price 2 Nov

NA

Reliance on connection fees

① 71% profit contributed from connection fees

For the business model, Tian Lun relies on gas connection revenue. In 1H10, around 51% of total revenue, 81% of total gross profit and 71% of the profit were derived from connection fees. New connection in FY08 and FY09 are 22,000 and 42,000 units respectively, and in 1H10 another 27,000 users have been added. Accumulated units of users at 30 Jun 2010 are 136,645. Connection fee has been the same all the way from FY08 till now at RMB2,792.

② Only 3 projects in 2 cities and 1 district

Three projects are currently in operation, namely Hebi, Xuchang and Shangjie District in Zhengzhou. On top of 136,645 users from residents and C&I customers, there are 2 CNG stations in Hebi and Xuchang. Total yearly gas related sales volume including natural gas, coal gas and CNG in FY09 and 1H10 was 52.76mn m3 and 28.77mn m3 respectively. Coal gas volume sold has reduced from 14.8mn m3 in 1H09 to 10.1mn m3 in 1H10 while natural gas sales volume increased from 11.4mn m3 in 1H09 to 15.4mn m3 in 1H10. Tariff ranges from the lowest in Zhengzhou's average of RMB1.44/m3 to the highest in Xuchang of RMB2.48/m3 including all types of users.

③ FY10F bottom line not less than RMB66.1mn

According to prospectus, FY10F's bottom line will not be less than RMB66.1mn.

④ IPO proceeds mainly for M&A in Henan

Per the prospectus, 50.5% of the IPO proceeds will be used to acquire or develop 3 selected urban gas projects (no MOU signed) in Henan. The remainder will be for construction of gas processing stations and networks (17.6%), gas filling station (6%), LNG and bio-fuel (15.9%).

Key financials

| | FY07 | FY08 | FY09 | Guided |
|---------------------|------|-------|-------|--------|
| Revenue | 65.9 | 127.7 | 179.2 | ↑ |
| Reported net profit | 7.5 | 23.5 | 44.3 | ↑ |
| Reported EPS | NA | NA | NA | ↔ |
| Rep EPS growth (%) | NA | NA | NA | ↔ |
| Rep P/E (x) | NA | NA | NA | ↔ |
| Price/book (x) | NA | NA | NA | ↔ |
| Dividend yield (%) | NA | NA | NA | ↔ |
| ROE (%) | 31% | 57% | 53% | ↓ |
| Net debt/equity (%) | 473% | 133% | 56% | ↓ |

Source: Company data

Share price relative to MSCI China

Listing 10 November

| | 1m | 3m | 6m |
|----------------------------------|----|----|-------|
| Absolute (LC\$) | NA | NA | NA |
| Absolute (US\$) | NA | NA | NA |
| Relative to Index | NA | NA | NA |
| Market cap (US\$m) | | | NA |
| Estimated free float (%) | | | NA |
| 52-week range (HK\$) | | | NA |
| 3-mth avg daily turnover (US\$m) | | | NA |
| Major shareholders | | | |
| Zhang Yingcen | | | 70.0% |
| Name 2 | | | |

Source: Bloomberg

Financial statements

| Income Statement (RMBmn) | 2007A | 2008A | 2009A |
|-------------------------------------|-----------|-----------|-----------|
| Revenue | 66 | 128 | 179 |
| COS | (37) | (78) | (100) |
| Gross Profit | 29 | 50 | 79 |
| EBITDA | (25) | (117) | 32 |
| Other income | (1) | (2) | (0) |
| SG&A | (58) | (172) | (54) |
| EBIT | (30) | (124) | 25 |
| Interest income | 2 | 2 | 1 |
| Reported OP | (29) | (122) | 26 |
| Finance cost | (11) | (10) | (7) |
| Others | 81 | 286 | 17 |
| Profit before tax | 12 | 32 | 62 |
| Income tax | (4) | (7) | (14) |
| Net Profit | 8 | 26 | 48 |
| Profit from discontinued operations | - | - | - |
| Minority Interest | (1) | (2) | (3) |
| Net Profit to equity holders | 8 | 24 | 44 |
| Year-end shares | 38 | 38 | 38 |
| Basic EPS (HK\$) | NA | NA | NA |
| FD EPS (HK\$) | NA | NA | NA |
| BPS (HK\$) | NA | NA | NA |
| DPS (HK\$) | - | - | - |

| Balance Sheet (RMBmn) | 2007A | 2008A | 2009A |
|-------------------------------------|------------|------------|------------|
| Cash and Equivalent | 8 | 11 | 15 |
| Account Receivable | 43 | 45 | 71 |
| Inventories | 22 | 20 | 18 |
| Others | 1 | - | - |
| Total current assets | 74 | 76 | 103 |
| PP&E | 113 | 119 | 125 |
| Intangible assets | 32 | 31 | 32 |
| Investment in associates and JCEs | - | - | - |
| Others | 25 | 23 | 11 |
| Total non-current assets | 169 | 173 | 168 |
| Total Assets | 244 | 249 | 271 |
| ST debt | 38 | 28 | 40 |
| Account Payable | 46 | 49 | 39 |
| Others | 46 | 49 | 45 |
| Total current liabilities | 131 | 126 | 125 |
| LT debt | 85 | 60 | 35 |
| Others | - | - | 1 |
| Total LT liabilities | 85 | 60 | 36 |
| Total Liabilities | 216 | 186 | 160 |
| Equity Capital | - | - | - |
| Reserves | 25 | 58 | 108 |
| Shareholder's equity | 25 | 58 | 108 |
| Minority interest | 3 | 5 | 3 |
| Total Liabilities and Equity | 244 | 249 | 271 |

| Ratio Analysis | 2007A | 2008A | 2009A |
|-----------------------|-------|-------|-------|
| ROE | 31% | 57% | 53% |
| ROA | 3% | 10% | 17% |
| ROIC | 5% | 17% | 26% |
| Net gearing | 473% | 133% | 56% |
| Debt/equity | 505% | 152% | 70% |
| Debt/capital | 88% | 65% | 45% |
| Interest coverage (X) | NA | NA | NA |
| Dividend payout ratio | 0% | 0% | 0% |

Source: Company data



Key findings

On 8 Oct, 56.87% of ZGC shares were held by a JV, which is 80% owned by CR Gas. The offer price was HK\$14.73 and latest closing price of ZGC was HK\$16.72 on 2 Nov 2010. According to the plans of Zhengzhou Municipal Government, 100,000 mu (66.67mn sqm) of land and 300,000 ordinary residents are involved in Zhengzhou government's new development plan to reconstruct 143 urban villages. At 30 Jun 2010, ZGC had 931,263 residential customers (up 6.4% y-y), and 36,087 vehicular users (up 5.5% y-y).

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

ZGC is principally engaged in the sale of natural gas, pressure control equipment and gas appliances, the construction of gas pipelines and the provision of gas pipelines renovation services.

Closing price on 2 Nov \$16.72

57% owned by our top-pick CRG

① Unconditional offer from CR Gas

On 8 Oct, 56.87% of ZGC shares were held by the JV which is 80% owned by CR Gas. The offer price was HK\$14.73 and latest closing price of ZGC was HK\$16.72 per share at 2 Nov 2010. With the ownership from CR Gas, ZGC can leverage on CR Gas's expertise in the area to further expand into downstream business.

② Residential customer and CNG expansion

According to the plans of Zhengzhou Municipal Government, 100,000 mu (66.67mn sqm) of land and 300,000 ordinary residents are involved in Zhengzhou government's new development plan to reconstruct 143 urban villages. ZGC has already invested RMB22mn to develop CNG stations and gas-fired vehicles with Zhengzhou Traffic and Transportation. At 30 Jun 2010, ZGC had 931,263 residential customers (up 6.4% y-y), and 36,087 vehicular users (up 5.5% y-y).

③ Vehicular users tariff up 44% on 1 Jul

Except for residential users, the natural gas tariff in Zhengzhou for commercial, industrial and vehicular users' tariff were increased by 2.1%, 5.1% and 44% to RMB2.86/m³, RMB3.32/m³ and RMB3.60/m³ respectively. Zhengzhou government said in a press conference that residential tariff increase would have to be ordered from the provincial level and go through public hearing in Zhengzhou, and the possibility for a hike remains.

④ W2E gas supply boosted as well as average cost

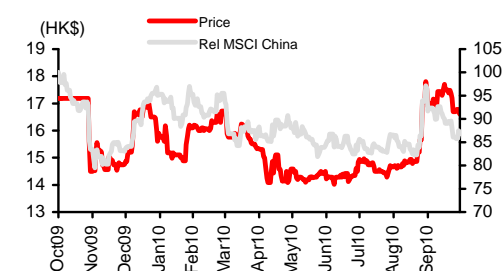
W2E gas contributed 68.8%, 79.0% and 82.1% respectively of total gas supply of FY08, FY09 and 1H10. Average gas purchase cost rose to RMB1.52/m³ in 1H10, up 11.8% y-y. GM of pipeline natural gas was thus down 3.5pps y-y to 14.5% in 1H10, which was still higher than 12.7% and 13.6% in FY08 and FY09, respectively.

Key financials

| | FY07 | FY08 | FY09 | Guided |
|---------------------|----------|----------|----------|--------|
| Revenue | 862 | 1,029 | 1,244 | ↑ |
| Reported net profit | 128 | 151 | 178 | ↑ |
| Reported EPS | 1.03 | 1.21 | 1.43 | ↑ |
| Rep EPS growth (%) | 43 | 19 | 15 | ↓ |
| Rep P/E (x) | 13.4 | 6.1 | 10.7 | ↔ |
| Price/book (x) | 2.6 | 1.2 | 2.2 | ↔ |
| Dividend yield (%) | 2.1 | 2.0 | 3.3 | ↑ |
| ROE (%) | 20.9 | 21.0 | 21.9 | ↑ |
| Net debt/equity (%) | net cash | net cash | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|--------------------------------------|-------|------|-------------|
| Absolute (LC\$) | (1.5) | 11.8 | 9.3 |
| Absolute (US\$) | (1.4) | 11.9 | 9.5 |
| Relative to Index | (7.9) | 1.9 | (1.1) |
| Market cap (US\$mn) | | | 2,700 |
| Estimated free float (%) | | | 32.7 |
| 52-week range (HK\$) | | | 17.80/14.02 |
| 3-mth avg daily turnover (US\$mn) | | | 0.54 |
| Major shareholders | | | |
| China Resources National Corporation | | | 8.9% |

Source: Bloomberg

Financial statements

| Income Statement (RMBmn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Revenue | 732 | 862 | 1,029 | 1,244 |
| COGS | -490 | -564 | -717 | -866 |
| Gross Profit | 242 | 299 | 312 | 378 |
| EBITDA | 160 | 225 | 239 | 286 |
| Other income | -9 | -9 | -4 | 6 |
| SG&A | -100 | -96 | -109 | -128 |
| EBIT | 133 | 194 | 199 | 241 |
| Interest income | 2 | 3 | 4 | 5 |
| Reported OP | 135 | 196 | 204 | 245 |
| Finance cost | 0 | 0 | 0 | -2 |
| Others | 0 | 0 | 0 | 0 |
| Profit before tax | 135 | 196 | 204 | 244 |
| Income tax | -10 | -67 | -52 | -63 |
| Net Profit | 126 | 130 | 152 | 180 |
| Minority Interest | 14 | 1 | 1 | 2 |
| Net Profit to equity holders | 111 | 128 | 151 | 178 |
| Year-end shares | 125 | 125 | 125 | 125 |
| Basic EPS (RMB) | 0.891 | 1.026 | 1.208 | 1.426 |
| Recurring EPS (RMB) | 0.891 | 1.026 | 1.208 | 1.426 |
| FD EPS (RMB) | 0.891 | 1.026 | 1.208 | 1.426 |
| BPS (RMB) | 4.532 | 5.274 | 6.240 | 6.762 |
| DPS (RMB) | 0.285 | 0.243 | 0.904 | 0.163 |

| Key Assumptions | 2006A | 2007A | 2008A | 2009A |
|---|------------|------------|--------------|--------------|
| Sales of NG | | | | |
| Sales Volume (mn m3) | 286 | 334 | 395 | 447 |
| From Residential users | 101 | 114 | 139 | 149 |
| From Commercial users | 89 | 111 | 126 | 155 |
| From Industrial users | 56 | 65 | 73 | 70 |
| From CNG | 41 | 44 | 60 | 71 |
| Revenue (RMB mn) | 499 | 605 | 747 | 930 |
| NG procurement volume (mn m3) | 307 | 355 | 416 | 476 |
| From W-E pipeline | 218 | 254 | 285 | 376 |
| From Zhongyuan Oil field | 79 | 67 | 32 | 19 |
| From Other sources | 10 | 34 | 99 | 81 |
| Connection Fee | | | | |
| Connection Fee household (RMB) | 3,583 | 3,160 | 3,062 | 3,239 |
| No. of Newly connected household ('000) | 61 | 76 | 73 | 85 |
| Revenue (RMB mn) | 223 | 246 | 271 | 302 |
| Overall | | | | |
| Other Revenue (RMB mn) | 20 | 20 | 20 | 23 |
| Gross Revenue (RMB mn) | 742 | 871 | 1,039 | 1,255 |
| Business tax and surcharges | 10 | 9 | 10 | 11 |
| Net Revenue (RMB mn) | 732 | 862 | 1,029 | 1,244 |
| Total Gross Profit (RMB mn) | 241.7 | 298.6 | 311.8 | 378.4 |
| GPM (%) | 33% | 35% | 30% | 30% |

| Growth Analysis | 2006A | 2007A | 2008A | 2009A |
|----------------------------|-------|-------|-------|-------|
| Revenue | 18% | 18% | 19% | 21% |
| Gross Profit | 15% | 24% | 4% | 21% |
| EBIT | 6% | 46% | 3% | 21% |
| Net Profit to shareholders | 19% | 15% | 18% | 18% |
| P&L Analysis | 2006A | 2007A | 2008A | 2009A |
| GPM | 33% | 35% | 30% | 30% |
| EBITDA Margin | 22% | 26% | 23% | 23% |
| EBIT Margin | 18% | 22% | 19% | 19% |
| NPM | 15% | 15% | 15% | 14% |

Source: Company data

| Balance Sheet (RMBmn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|--------------|--------------|--------------|
| Cash and Equivalent | 177 | 219 | 368 | 292 |
| Account Receivable | 95 | 117 | 105 | 161 |
| Inventories | 5 | 6 | 15 | 18 |
| Others | 46 | 58 | 67 | 122 |
| Total current assets | 323 | 400 | 555 | 593 |
| PP&E | 595 | 632 | 666 | 842 |
| Intangible assets | 18 | 67 | 114 | 113 |
| Investment in associates and JCEs | 0 | 0 | 32 | 33 |
| Others | 9 | 6 | 7 | 9 |
| Total non-current assets | 622 | 705 | 819 | 996 |
| Total Assets | 946 | 1,105 | 1,375 | 1,589 |
| ST debt | 0 | 0 | 40 | 0 |
| Account Payable | 65 | 64 | 56 | 163 |
| Others | 310 | 377 | 494 | 557 |
| Total current liabilities | 375 | 441 | 590 | 720 |
| LT debt | 0 | 0 | 0 | 0 |
| Deferred taxes | 0 | 0 | 0 | 0 |
| Total LT liabilities | 0 | 0 | 0 | 0 |
| Total Liabilities | 375 | 441 | 590 | 720 |
| Equity Capital | 125 | 125 | 125 | 125 |
| Reserves | 442 | 535 | 656 | 721 |
| Shareholder's equity | 567 | 660 | 781 | 846 |
| Minority interest | 4 | 4 | 4 | 23 |
| Total Liabilities and Equity | 946 | 1,105 | 1,375 | 1,589 |

| Cash Flow Statement (RMBmn) | 2006A | 2007A | 2008A | 2009A |
|------------------------------------|-------------|-------------|-------------|-------------|
| EBIT | 133 | 194 | 199 | 241 |
| Depreciation and Amortization | 27 | 32 | 38 | 46 |
| Change of NWC | 25 | 25 | 119 | 52 |
| Tax Paid | -15 | -50 | -60 | -54 |
| Interest paid | 0 | 0 | 0 | -2 |
| Others | 5 | 1 | 4 | 1 |
| Operating Cash Flow | 174 | 201 | 300 | 284 |
| CAPEX | -157 | -127 | -126 | -231 |
| Acquisitions | -10 | 0 | -32 | 0 |
| Interest received | 2 | 3 | 4 | 4 |
| Others | 1 | 1 | 0 | 4 |
| Investing Cash Flow | -164 | -123 | -153 | -223 |
| Net borrowings | 0 | 0 | 40 | -40 |
| Equity Issue | 0 | 0 | 0 | 0 |
| Capital contribution from minority | 0 | 0 | 0 | 18 |
| Interest and dividend | -17 | -36 | -30 | -113 |
| Others | 0 | -1 | -7 | -2 |
| Financing Cash Flow | -18 | -36 | 3 | -137 |
| FX Effect | 0 | 0 | 0 | 0 |
| Net Cash Flow Change | -7 | 42 | 149 | -76 |
| Year-end Cash Flow | 178 | 219 | 368 | 292 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|----------|----------|----------|----------|
| ROE | 22% | 21% | 21% | 22% |
| ROA | 13% | 12% | 12% | 12% |
| ROIC | 22% | 21% | 21% | 20% |
| Net gearing | net cash | net cash | net cash | net cash |
| Debt/equity | 0% | 0% | 5% | 0% |
| Debt/capital | 0% | 0% | 0% | 0% |
| Interest coverage (X) | n.m. | n.m. | n.m. | 172.2 |
| Dividend payout ratio | 32% | 24% | 75% | 11% |

Source: Company data



Key findings

On 6 Aug, 56% of issued capital and options representing 7% of total share were purchased by China Gas (REDUCE), at a consideration of ~HK\$2bn. Further to the acquisition, the mandatory public float requirement for Zhongyu Gas was not reached. According to the company's announcement, China Gas would try to prevent Zhongyu Gas from delisting. As at 30 Jun 2010, Zhongyu Gas has secured eight coal blocks. Further trial and exploration works are required to master the reserve estimate before actual production.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

Zhongyu Gas is principally engaged in the development, construction and operation of natural gas, LPG and exploring coalbed gas projects in the PRC.

Closing price on 2 Nov \$0.71

China Gas has 56% interest

① 56% stake acquired by China Gas

On 6 Aug, 56% of issued capital and options representing 7% of total share were purchased by China Gas (REDUCE) at a consideration of HK\$2bn. The acquisition represented 2.5x PB and 44x on FY09 numbers. Further to the acquisition, given the mandatory public float requirement was not reached, China Gas would try to prevent Zhongyu Gas from delisting, according to the announcement.

② 8 Coalbed methane blocks secured

At the end of 30 Jun, Zhongyu Gas secured eight coal blocks, located in Jiaozuo, Zhengzhou, Pingdingshan (including Yuzhou and Ruzhou), Hebi, Yima, Yongxia in Henan Province. The company intends to explore, exploit, develop and produce CBM in these sites. For Jiaozuo, the estimated low, medium and high gas volume to be 118bcm, 168bcm and 263bcm respectively. The company will extend the trial and exploration to better master the reserve estimate, before any commercial production starts.

③ 11 projects with 3.28mn population coverage

As at 30 Jun 2010, Zhongyu Gas operated 11 gas projects, 3 in Shandong and 8 in Henan. The total connectable urban population for these 11 projects was ~3.28mn, with an estimated connected household of ~925mn in aggregate. The company also had CNG stations, with 5 in operation, and 2 (in Luohe and Nanjing) under development.

④ Gas sales volume up 37% in 1H10

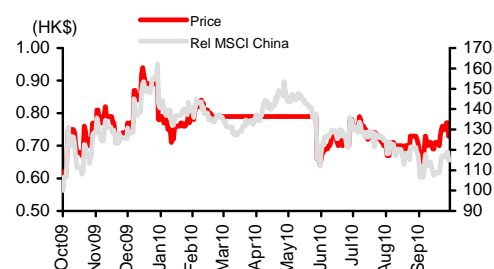
In 1H10 Zhongyu Gas sold 141.6mn m3 of gas, representing a 37% y-y increase vs 1H09. For 1H10, new household connection was 26,636 and new C&I users were 129, representing a penetration rate of 40%. In 1H10, the company sold 14.5mn m3 and 3,103 tons for its CNG stations and bottled LPG business respectively.

Key financials

| | 2007 | 2008 | 2009 | Guided |
|---------------------|----------|----------|----------|--------|
| Revenue | 295 | 703 | 844 | ↑ |
| Reported net profit | -26 | -93 | 20 | ↔ |
| Reported EPS | -0.015 | -0.048 | 0.010 | ↔ |
| Rep EPS growth (%) | -392% | 215% | -122% | ↔ |
| Rep P/E (x) | -157.9 | -7.9 | 118.3 | ↑ |
| Price/book (x) | 6.7 | 1.1 | 3.5 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | -6% | -14% | 3% | ↔ |
| Net debt/equity (%) | net cash | net cash | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|-----|--------|-----------|
| Absolute (LC\$) | 9.2 | (6.6) | (10.1) |
| Absolute (US\$) | 9.4 | (6.4) | (10.0) |
| Relative to Index | 2.9 | (16.5) | (20.6) |
| Market cap (US\$m) | | | 178.1 |
| Estimated free float (%) | | | 38.3 |
| 52-week range (HK\$) | | | 0.94/0.64 |
| 3-mth avg daily turnover (US\$m) | | | 0.020 |
| Major shareholders | | | |
| China Gas Holdings Limited | | | 85.1% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|---------------|---------------|--------------|
| Revenue | 78 | 295 | 703 | 844 |
| COS | (52) | (192) | (477) | (587) |
| Gross Profit | 27 | 103 | 226 | 257 |
| EBITDA | 16 | 45 | 98 | 143 |
| Other income | 8 | 2 | 7 | 7 |
| SG&A | (23) | (75) | (174) | (160) |
| EBIT | 11 | 30 | 60 | 104 |
| Interest income | 0 | 9 | 7 | 3 |
| Reported OP | 11 | 39 | 67 | 107 |
| Finance cost | (4) | (28) | (53) | (44) |
| Others | (11) | (68) | (159) | (90) |
| Profit before tax | 8 | (18) | (78) | 80 |
| Income tax | - | (4) | (13) | (35) |
| Net Profit | 8 | (22) | (92) | 45 |
| Profit from discontinued operations | - | - | - | - |
| Minority Interest | (0) | (3) | (1) | (25) |
| Net Profit to equity holders | 7 | (26) | (93) | 20 |
| Year-end shares | 1,325 | 1,944 | 1,934 | 1,949 |
| Basic EPS (HK\$) | 0.01 | (0.02) | (0.05) | 0.01 |
| FD EPS (HK\$) | 0.01 | (0.02) | (0.05) | 0.01 |
| BPS (HK\$) | 0.138 | 0.358 | 0.339 | 0.356 |
| DPS (HK\$) | - | - | - | - |

| Balance Sheet (HK\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|--------------|--------------|--------------|
| Cash and Equivalent | 66 | 366 | 474 | 414 |
| Account Receivable | 3 | 27 | 57 | 30 |
| Inventories | 11 | 34 | 39 | 36 |
| Others | 62 | 235 | 61 | 57 |
| Total current assets | 141 | 662 | 632 | 537 |
| PP&E | 112 | 457 | 564 | 697 |
| Intangible assets | 28 | 353 | 279 | 364 |
| Investment in associates and JCEs | - | - | - | - |
| Others | - | 45 | 47 | 33 |
| Total non-current assets | 139 | 854 | 890 | 1,094 |
| Total Assets | 280 | 1,516 | 1,522 | 1,631 |
| ST debt | 36 | 201 | 115 | 243 |
| Account Payable | 16 | 59 | 69 | 17 |
| Others | 15 | 215 | 460 | 303 |
| Total current liabilities | 67 | 476 | 643 | 564 |
| LT debt | 22 | 59 | 100 | 63 |
| Others | 0 | 220 | 17 | 191 |
| Total LT liabilities | 22 | 279 | 117 | 254 |
| Total Liabilities | 89 | 754 | 760 | 817 |
| Equity Capital | 13 | 19 | 19 | 19 |
| Reserves | 170 | 677 | 636 | 674 |
| Shareholder's equity | 183 | 697 | 656 | 694 |
| Minority interest | 8 | 65 | 106 | 120 |
| Total Liabilities and Equity | 280 | 1,516 | 1,522 | 1,631 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|----------|----------|----------|----------|
| ROE | 4% | -6% | -14% | 3% |
| ROA | 3% | -3% | -6% | 1% |
| ROIC | 4% | -4% | -23% | 3% |
| Net gearing | net cash | net cash | net cash | net cash |
| Debt/equity | 32% | 37% | 33% | 44% |
| Debt/capital | 33% | 44% | 54% | 52% |
| Interest coverage (X) | 4.5 | 1.6 | 1.9 | 3.2 |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data



Key findings

At the end of 1H10, EE indirectly owned 31% in a CBM project in Xinjiang, with estimated CBM reserves of 0.81bcm. However, the commercial production date is not disclosed by the company. Given the investment for the Xinjiang CBM investment, on Sep 20, EE placed 345.5mn new shares at ~HK\$0.444 to raise HK\$160.7mn. As of 1H10, EE recorded a net loss of HK\$26.9mn, a modest improvement of 3% from the prior year period net loss of HK\$27.8mn.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

Exploitation of petroleum resources activities and production of petroleum are the current revenue generating activities of EE. CBM business is currently under exploration.

Closing price on 2 Nov \$0.46

Another CBM punter

① Investment in a 0.81bcm CBM reserve in Xinjiang

Although the traditional business of the company is oil business, the company starts to invest in CBM business. At the end of 1H10, EE indirectly owned 31% in a production sharing contract for a CBM project in Xinjiang Uygur Autonomous Region in PRC (through a 65%-owned company named TerraWest Energy, which in turns owns a 47%-JV with China United Coalbed Methane Corporation Limited). The project is estimated to have 0.81bcm of reserves. However, commercial production date is not disclosed by the company.

② Oil business selling 9,000 barrels a month

In 1H10, average monthly oil production for the company was ~9,000 barrels, with the crude oil price in PRC maintained at >US\$70/bbl. As a result, the bottom line of Qian An oil field (50%-owned by EE) improved to HK\$1.0mn, from a net loss of HK\$3.4mn in 1H09.

③ 1H10 loss of HK\$27mn

In 1H10, EE recorded revenue decline of 34% to HK\$126mn from HK\$191mn. Bottom line remained largely stable with slight improvement of 3%, resulting in a loss of HK\$26.9mn, thanks to the shared profit from the associate of HK\$1mn and other gain of HK\$0.5mn. Starting from FY06, the company remained in a loss position, with the FY09 net loss increased to over HK\$106mn.

④ Placed 345.5mn shares for CBM fund raising

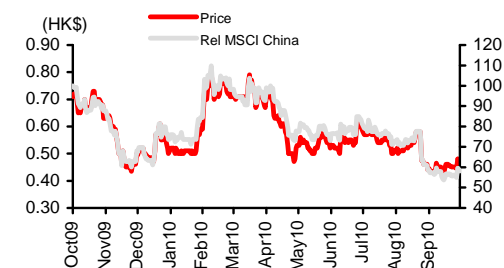
On Sep 20, EE placed 345.5mn new shares at ~HK\$0.444 to raise HK\$160.7mn for the Xinjiang CBM project. The tranche of the placed shares represent 14.2% of the issued shares prior to the placement and 12.44% afterwards.

Key financials

| | FY07 | FY08 | FY09 | Guided |
|---------------------|----------|----------|----------|--------|
| Revenue | 3.4 | 2.2 | 0.3 | ↓ |
| Reported net profit | -46.0 | -11.1 | -106.6 | ↔ |
| Reported EPS | -0.084 | -0.005 | -0.046 | ↔ |
| Rep EPS growth (%) | 328% | -94% | 831% | ↔ |
| Rep P/E (x) | -28.4 | -77.6 | -27.0 | ↔ |
| Price/book (x) | 5.3 | 12.5 | 44.3 | ↑ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | -19% | -2% | -18% | ↔ |
| Net debt/equity (%) | net cash | net cash | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|-----------------------------------|-------|--------|-----------|
| Absolute (LC\$) | 4.6 | (20.2) | (35.9) |
| Absolute (US\$) | 4.7 | (20.0) | (35.8) |
| Relative to Index | (1.7) | (30.1) | (46.4) |
| Market cap (US\$mn) | | | 163.0 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 0.80/0.43 |
| 3-mth avg daily turnover (US\$mn) | | | 0.43 |
| Major shareholders | | | |
| Chan Wing-Him Kenny | | | 44.1% |
| Li Ka-Shing | | | 8.2% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$m) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|---------------|---------------|---------------|----------------|
| Revenue | 7.0 | 3.4 | 2.2 | 0.3 |
| COS | (6.6) | (2.9) | (1.8) | (0.2) |
| Gross Profit | 0.4 | 0.5 | 0.4 | 0.1 |
| EBITDA | (6.6) | (45.7) | (169.3) | (43.1) |
| Other income | 0.7 | 5.9 | (6.8) | (0.6) |
| SG&A | (8.2) | (52.6) | (163.9) | (44.1) |
| EBIT | (7.1) | (46.2) | (170.4) | (44.6) |
| Interest income | 0.0 | 0.2 | 6.8 | 0.0 |
| Reported OP | (7.1) | (46.0) | (163.5) | (44.5) |
| Finance cost | - | - | - | - |
| Others | 6.5 | 46.0 | 313.7 | (18.4) |
| Profit before tax | (7.8) | (46.0) | (13.3) | (107.5) |
| Income tax | - | - | - | - |
| Net Profit | (7.8) | (46.0) | (13.3) | (107.5) |
| Profit from discontinued operations | - | - | - | - |
| Minority Interest | (0.2) | - | 2.2 | 0.9 |
| Net Profit to equity holders | (8.0) | (46.0) | (11.1) | (106.6) |
| Year-end shares | 396 | 1,075 | 20,000 | 20,000 |
| Basic EPS (HK\$) | (0.02) | (0.08) | (0.00) | (0.05) |
| FD EPS (HK\$) | (0.02) | (0.08) | (0.00) | (0.05) |
| BPS (HK\$) | -0.011 | 0.450 | 0.030 | 0.028 |
| DPS (HK\$) | - | - | - | - |

| Balance Sheet (HK\$m) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|----------------|----------------|
| Cash and Equivalent | 0.5 | 395.1 | 133.7 | 79.5 |
| Account Receivable | 0.7 | 0.2 | 0.1 | 0.0 |
| Inventories | 0.0 | - | - | - |
| Others | 1.2 | 94.5 | 19.6 | 24.7 |
| Total current assets | 2.4 | 489.9 | 153.4 | 104.2 |
| PP&E | 0.7 | 0.5 | 864.9 | 1,025.7 |
| Intangible assets | - | - | - | - |
| Investment in associates and JCEs | - | - | 70.3 | 2.7 |
| Others | - | - | 3.0 | 3.8 |
| Total non-current assets | 0.7 | 0.5 | 938.3 | 1,032.2 |
| Total Assets | 3.0 | 490.4 | 1,091.7 | 1,136.5 |
| ST debt | - | - | - | - |
| Account Payable | 1.5 | 0.1 | 12.3 | 13.6 |
| Others | 5.7 | 7.2 | 31.8 | 27.3 |
| Total current liabilities | 7.2 | 7.2 | 44.1 | 40.9 |
| LT debt | - | - | - | - |
| Others | - | - | 206.6 | 240.9 |
| Total LT liabilities | - | - | 206.6 | 240.9 |
| Total Liabilities | 7.2 | 7.2 | 250.6 | 281.8 |
| Equity Capital | 4.0 | 5.4 | 5.8 | 6.1 |
| Reserves | (8.1) | 477.8 | 603.9 | 549.5 |
| Shareholder's equity | (4.2) | 483.1 | 609.7 | 555.5 |
| Minority interest | - | - | 231.3 | 299.1 |
| Total Liabilities and Equity | 3.0 | 490.4 | 1,091.7 | 1,136.5 |

| Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|----------|----------|----------|----------|
| ROE | 193% | -19% | -2% | -18% |
| ROA | -263% | -19% | -1% | -10% |
| ROIC | 173% | -52% | -2% | -22% |
| Net gearing | net cash | net cash | net cash | net cash |
| Debt/equity | 0% | 0% | 0% | 0% |
| Debt/capital | 0% | 0% | 0% | 0% |
| Interest coverage (X) | NA | NA | NA | NA |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data



Key findings

On 28 Jun 2010, Tianjin Gas announced it would contribute its share of the JV with CR Gas (BUY) by injecting its natural gas-related operational assets (which include the shares of TT held by Tianjin Gas) into the JV. The JV will be owned 49% by CR Gas and 51% by Tianjin Gas. The project is at the due diligence stage and expected to be completed by end 2010 or early 2011. In 1H10, TT generated revenue of RMB165.7mn with GPM of 24.4%, representing y-y changes of 21% increase and 1.3pps decline. 1H10's bottom-line was RMB26.7mn compared to RMB23.6mn in 1H09.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

JV asset of CR Gas

① Injecting into JV of Tianjin Gas and CR Gas

TT supplies gas to an area of 31.5 sq km in Tianjin with mid-low pressure pipeline of 142km. In Inner Mongolia's city of Jining, TT covers an area of 40 sq km with 14.76km mid-low pipeline installed. On 28 Jun 2010, Tianjin Gas announced it would contribute its share of the JV with CR Gas (BUY) by injecting its natural gas-related operational assets (which include the shares of TT held by Tianjin Gas) into the JV. The JV will be owned 49% by CR Gas and 51% by Tianjin Gas. The project is now at the due diligence stage and expected to be completed by end 2010 or early 2011.

② 1H10 recorded revenue growth of 21% y-y

In 1H10, TT generated revenue of RMB165.7mn with GPM of 24.4%, representing y-y change of 21% increase and 1.3pps decline respectively. Net profit was RMB26.7mn compared to RMB23.6mn in 1H09. In FY08, the company announced its first ever final dividend of HK\$0.015 per share; while no dividend was announced for FY09.

③ Balanced development of gas businesses

TT said it would focus on the balanced development of various gas-related businesses and make efforts to develop the piped gas market, including participating in the urban natural gas pipeline network projects in local areas by way of mergers or acquisitions. TT said it would further expand the operation in piped gas sales, new connections, gas transportation and appliances sales, in order to attain its strategic objectives for the remaining period of this year.

NUGGETS

Non-rated ideas from Nomura

Company description

TT's principal activities are the operation and management of gas pipeline infrastructure and the sale and distribution of piped gas in Tianjin and Inner Mongolia.

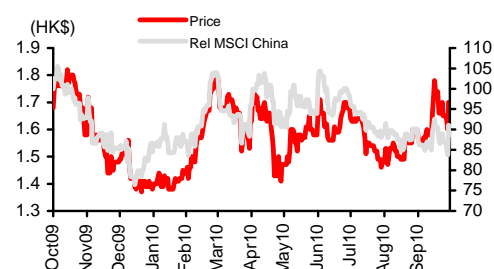
Closing price on 2 Nov \$1.62

Key financials

| | FY07 | FY08 | FY09 | Guided |
|---------------------|----------|----------|----------|--------|
| Revenue | 173 | 217 | 318 | ↑ |
| Reported net profit | 62 | 60 | 66 | ↔ |
| Reported EPS | 0.062 | 0.054 | 0.058 | ↔ |
| Rep EPS growth (%) | 114% | -13% | 7% | ↔ |
| Rep P/E (x) | 37.1 | 7.6 | 26.0 | ↑ |
| Price/book (x) | 8.3 | 0.8 | 2.7 | ↔ |
| Dividend yield (%) | 0% | 0% | 1% | ↑ |
| ROE (%) | 25% | 14% | 11% | ↓ |
| Net debt/equity (%) | net cash | net cash | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|-------|--------|-----------|
| Absolute (LC\$) | 4.5 | (1.2) | (6.4) |
| Absolute (US\$) | 4.6 | (1.1) | (6.2) |
| Relative to Index | (1.8) | (11.1) | (16.8) |
| Market cap (US\$m) | | | 104.5 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 1.82/1.37 |
| 3-mth avg daily turnover (US\$m) | | | 0.045 |
| Major shareholders | | | |
| Martin Currie (Holdings) Limited | | | 9.2% |
| Law Suet Yi | | | 8.9% |

Source: Bloomberg

Financial statements

| Income Statement (HK\$m) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Revenue | 94 | 173 | 217 | 318 |
| COS | (37) | (68) | (110) | (222) |
| Gross Profit | 57 | 105 | 107 | 96 |
| EBITDA | 52 | 104 | 90 | 104 |
| Other income | 3 | 4 | 8 | 8 |
| SG&A | (15) | (13) | (34) | (14) |
| EBIT | 45 | 96 | 81 | 90 |
| Interest income | 0 | 0 | 3 | 0 |
| Reported OP | 45 | 96 | 84 | 90 |
| Finance cost | (2) | (2) | (2) | (2) |
| Others | (45) | (96) | (84) | (89) |
| Profit before tax | 44 | 94 | 82 | 89 |
| Income tax | (15) | (32) | (21) | (23) |
| Net Profit | 28 | 62 | 60 | 66 |
| Profit from discontinued operations | - | - | - | - |
| Minority Interest | (0) | - | 0 | - |
| Net Profit to equity holders | 28 | 62 | 60 | 66 |
| Year-end shares | 995 | 995 | 1,150 | 1,150 |
| Basic EPS (HK\$) | 0.03 | 0.06 | 0.05 | 0.06 |
| FD EPS (HK\$) | 0.03 | 0.06 | 0.05 | 0.06 |
| BPS (HK\$) | 0.216 | 0.278 | 0.513 | 0.555 |
| DPS (HK\$) | - | - | - | 0.02 |

| Balance Sheet (HK\$m) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|------------|------------|------------|
| Cash and Equivalent | 32 | 70 | 245 | 187 |
| Account Receivable | 56 | 92 | 117 | 70 |
| Inventories | 1 | 1 | 1 | 0 |
| Others | 3 | 17 | 15 | 8 |
| Total current assets | 92 | 180 | 378 | 265 |
| PP&E | 185 | 185 | 65 | 234 |
| Intangible assets | 5 | 5 | 207 | 213 |
| Investment in associates and JCEs | - | - | 8 | 17 |
| Others | 0 | 0 | 17 | 7 |
| Total non-current assets | 190 | 190 | 296 | 471 |
| Total Assets | 282 | 370 | 673 | 736 |
| ST debt | 30 | 30 | 30 | 40 |
| Account Payable | 21 | 35 | 37 | 33 |
| Others | 15 | 27 | 16 | 23 |
| Total current liabilities | 66 | 92 | 83 | 97 |
| LT debt | - | - | - | - |
| Others | 1 | 0 | 1 | 1 |
| Total LT liabilities | 1 | 0 | 1 | 1 |
| Total Liabilities | 67 | 93 | 84 | 97 |
| Equity Capital | 100 | 100 | 115 | 115 |
| Reserves | 116 | 178 | 474 | 524 |
| Shareholder's equity | 215 | 277 | 589 | 639 |
| Minority interest | - | - | - | - |
| Total Liabilities and Equity | 282 | 370 | 673 | 736 |

| Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|----------|----------|----------|----------|
| ROE | 13% | 25% | 14% | 11% |
| ROA | 10% | 19% | 12% | 9% |
| ROIC | 13% | 26% | 16% | 14% |
| Net gearing | net cash | net cash | net cash | net cash |
| Debt/equity | 14% | 11% | 5% | 6% |
| Debt/capital | 14% | 13% | 8% | 8% |
| Interest coverage (X) | NA | NA | NA | NA |
| Dividend payout ratio | 0% | 0% | 0% | 26% |

Source: Company data



Key findings

According to management, currently the PRC is the only country that has a sizable market applying DME as an alternative source of energy, with in-house methanol plants possessing a yearly capacity of 250,000 tonnes. Management continues to believe the prospects for the DME market in PRC are good and is confident to improve profitability with DME's growth, although CEGY's performance still depends heavily on oil ASP.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

China Energy pioneered the use of dimethyl ether (DME) as an alternative clean energy source in the PRC and is now the market leader for DME.

Closing price on 2 Nov \$0.17

Firm believer in DME

① Firm believer in DME's prospects

Management continues to believe in the prospects for the DME market in the PRC. According to management, currently the PRC is the only country that has a sizable market applying DME as an alternative source of energy while interest has been shown in South East Asia and elsewhere in the world. In-house methanol plants have a yearly capacity of 250,000 tons.

② Performance heavily depending on crude ASP

Since crude's price fell from all time high of US\$147/barrel in July 08 to a low of US\$34/barrel by Dec 08, CEGY started making losses in the following FY09 and 1H10. CEGY's average DME selling price halved from RMB5,100/t in 2H08 to RMB2,530/t in 1H09. And as the company has stocked up the expensive inventory, production costs were not able to be lowered causing loss-making periods of FY09 and 1H10.

③ Still loss on bottom line in 1H10

In 1H10 sales recorded growth of 27.6% y-y, while gross loss and net loss were still existing, due to the surge in SG&A expenses resulting from the increased staff costs and option expenses from the company's expansion in Guangdong and Jiangsu. The ASP for DME recovered to RMB 2,600/t increasing inline with other major energy prices, with volume sold recorded as 133.2 tons.

④ 7% cheaper methanol purchasing in 3Q10

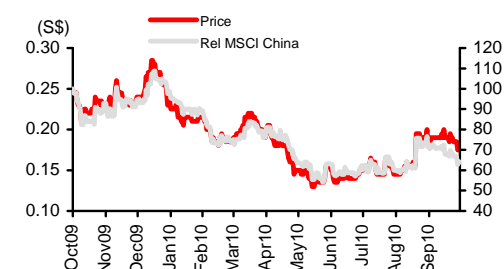
CEGY's has signed a supply agreement for a stable longer term supply of methanol for DME from Jiutai Energy Inner Mongolia whose methanol plant is projected to commence in 3Q10. The purchase price will be 7% cheaper than the market price. Management reckons this will help the Group to better manage its costs and margins.

Key financials

| | 2007 | 2008 | 2009 | Guided |
|---------------------|----------|-------|--------|--------|
| Revenue | 965 | 1,244 | 1,320 | ↑ |
| Reported net profit | 265 | 41 | -171 | ↓ |
| Reported EPS | 0.211 | 0.032 | -0.137 | ↓ |
| Rep EPS growth (%) | -6% | -85% | -528% | ↔ |
| Rep P/E (x) | 5.9 | 35.9 | n.m. | ↔ |
| Price/book (x) | 0.9 | 0.8 | 0.2 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | 17% | 2% | -10% | ↓ |
| Net debt/equity (%) | net cash | 30% | 36% | ↑ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|-----------------------------------|--------|------|------------|
| Absolute (LC\$) | (10.5) | 13.3 | (17.1) |
| Absolute (US\$) | (8.9) | 19.1 | (12.0) |
| Relative to Index | (17.2) | 3.6 | (29.2) |
| Market cap (US\$mn) | | | 165.3 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (HK\$) | | | 0.29/0.130 |
| 3-mth avg daily turnover (US\$mn) | | | 0.129 |
| Major shareholders | | | |
| Lianguo Cui | | | 50.6% |
| ASEAN China Investment | | | 5.6% |

Source: Bloomberg

Financial statements

| Income Statement (RMBmn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|--------------|---------------|
| Revenue | 680 | 965 | 1,244 | 1,320 |
| COS | (447) | (629) | (1,127) | (1,374) |
| Gross Profit | 233 | 335 | 117 | (54) |
| EBITDA | 257 | 379 | 190 | (38) |
| Other income | 8 | 18 | 31 | (9) |
| SG&A | (21) | (44) | (74) | (76) |
| EBIT | 219 | 309 | 74 | (139) |
| Interest income | 2 | 12 | 6 | 3 |
| Reported OP | 221 | 321 | 80 | (136) |
| Finance cost | (31) | (18) | (38) | (38) |
| Others | (221) | (321) | (80) | 136 |
| Profit before tax | 190 | 303 | 42 | (174) |
| Income tax | 1 | (38) | (1) | 3 |
| Net Profit | 192 | 265 | 40 | (171) |
| Profit from discontinued operations | - | - | - | - |
| Minority Interest | (0) | - | 0 | - |
| Net Profit to equity holders | 191 | 265 | 41 | (171) |
| Year-end shares | 1,253 | 1,253 | 1,253 | 1,253 |
| Basic EPS (HK\$) | 0.23 | 0.21 | 0.03 | (0.14) |
| FD EPS (HK\$) | 0.23 | 0.21 | 0.03 | (0.14) |
| BPS (HK\$) | 1.133 | 1.335 | 1.380 | 1.257 |
| DPS (HK\$) | - | - | - | - |

| Balance Sheet (RMBmn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Cash and Equivalent | 1,097 | 726 | 134 | 124 |
| Account Receivable | 19 | 51 | 20 | 49 |
| Inventories | 125 | 117 | 172 | 97 |
| Others | 153 | 167 | 242 | 225 |
| Total current assets | 1,394 | 1,061 | 567 | 495 |
| PP&E | 517 | 1,797 | 2,087 | 2,060 |
| Intangible assets | - | 92 | 91 | 89 |
| Investment in associates and JCEs | - | - | - | - |
| Others | - | 0 | 0 | 0 |
| Total non-current assets | 517 | 1,889 | 2,178 | 2,149 |
| Total Assets | 1,911 | 2,950 | 2,744 | 2,644 |
| ST debt | 234 | 581 | 626 | 532 |
| Account Payable | 257 | 627 | 365 | 378 |
| Others | - | - | - | - |
| Total current liabilities | 491 | 1,207 | 991 | 909 |
| LT debt | - | 70 | 25 | 160 |
| Others | - | - | - | - |
| Total LT liabilities | - | 70 | 25 | 160 |
| Total Liabilities | 491 | 1,277 | 1,016 | 1,069 |
| Equity Capital | 1,135 | 1,135 | 1,135 | 1,135 |
| Reserves | 285 | 538 | 593 | 440 |
| Shareholder's equity | 1,420 | 1,673 | 1,729 | 1,575 |
| Minority interest | - | - | - | - |
| Total Liabilities and Equity | 1,911 | 2,950 | 2,744 | 2,644 |

| Other Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|----------|----------|-------|-------|
| ROE | 13% | 17% | 2% | -10% |
| ROA | 10% | 11% | 1% | -6% |
| ROIC | 34% | 17% | 2% | -8% |
| Net gearing | net cash | net cash | 30% | 36% |
| Debt/equity | 16% | 39% | 38% | 44% |
| Debt/capital | 42% | 41% | 29% | 32% |
| Interest coverage (X) | NA | NA | NA | NA |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data

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Key findings

After 2 years of GDG's successful drilling in the GSS block (in Shanxi), GSS008 (the company's first SIS well in the field) has produced a total of 5mn m3 through June 2010. In addition, the pipeline gas distribution JV in Beijing continued to grow with a 7% increase y-y to 115mn m3 in 1H10. GDG has also plans to gain access to an additional 20 retail CNG stations in Henan. Overall, management expects continuous growth for this year, with the boost by the CBM business.

| Business model | SUPERIOR | SUSTAINABLE | INFERIOR |
|---------------------------|-------------|-------------|----------|
| Earnings/cashflow growth | HIGH | AVERAGE | LOW |
| Earnings/cashflow quality | HIGH | AVERAGE | LOW |
| Financial strength | STRONG | ADEQUATE | WEAK |
| Corporate governance | TRANSPARENT | ADEQUATE | LIMITED |
| Investment liquidity | HIGH | ADEQUATE | LOW |
| Volatility | LOW | MEDIUM | HIGH |

NUGGETS

Non-rated ideas from Nomura

Company description

GDG is a gas supplier based in China with a focus on the development, production, distribution and sales of natural gas from coal seams, commonly known as CBM.

Closing price on 2 Nov

GBP8.3

CBM in production

① 5mn m3 gas produced from GSS block

After 2 years of GDG's successful drilling in the GSS block (in Shanxi), GSS008, the company's first SIS well in the field, has been in operation for 833 days and produced a total of 5mn m3 through June 2010. The well is expected to continue the stable gas production rate. Similar successes from an additional 11 SIS wells drilled have enabled the block to proceed into a production phase.

② Increasing sales from midstream, downstream gas and equipment sales

In 1H10, mid-stream gas sales increased 4.3% y-y to 36mn m3; whereas for the downstream business, i.e. the pipeline gas distribution joint-venture, located around Beijing's outer ring road, also showed growth of 7% to 115mn m3. In addition the company reported growth in the equipment business, with an order of 140 units of CNG dispensers received in 1H10 from PetroChina; compared to 39 units in 1H09.

③ Revenue up 15% y-y in 1H10

With the above growth, revenue rose 15% y-y to US\$21.5mn in 1H10. This increase was in accordance with management expectations. Management expects such growth to continue this year as it is expected to record a significant contribution from CBM production.

④ Expanding into Henan

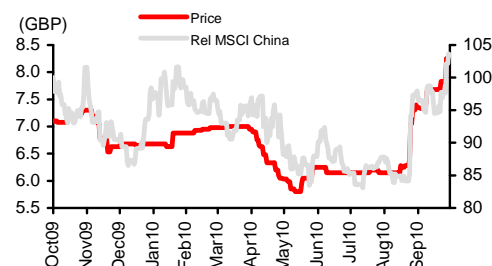
GDG targeted to gain access to an additional 20 CNG stations this year. These stations will be located in Henan which has over 100mn population.

Key financials

| | FY07 | FY08 | FY09 | Guided |
|---------------------|----------|----------|----------|--------|
| Revenue | 0 | 25 | 47 | ↑ |
| Reported net profit | -9 | -23 | -30 | ↓ |
| Reported EPS | -0.001 | -0.002 | -0.003 | ↓ |
| Rep EPS growth (%) | 107% | 142% | 23% | ↔ |
| Rep P/E (x) | n.m. | n.m. | n.m. | ↔ |
| Price/book (x) | 7.2 | 4.2 | 6.0 | ↔ |
| Dividend yield (%) | 0% | 0% | 0% | ↔ |
| ROE (%) | -2% | -5% | -6% | ↓ |
| Net debt/equity (%) | net cash | net cash | net cash | ↔ |

Source: Company data

Share price relative to MSCI China



| | 1m | 3m | 6m |
|----------------------------------|------|------|-----------|
| Absolute (LC\$) | 13.2 | 35.0 | 20.3 |
| Absolute (US\$) | 14.3 | 36.3 | 25.3 |
| Relative to Index | 7.0 | 25.3 | 10.3 |
| Market cap (US\$m) | | | 1,599 |
| Estimated free float (%) | | | 0.0 |
| 52-week range (GBP) | | | 8.30/5.80 |
| 3-mth avg daily turnover (US\$m) | | | 2.73 |
| Major shareholders | | | |
| Green Dragon Gas Holding | | | 73.6% |
| BlackRock Investment | | | 10.7% |

Source: Bloomberg

Financial statements

| Income Statement (US\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|---------------|---------------|---------------|---------------|
| Revenue | 0 | - | 25 | 47 |
| COS | (0) | - | (21) | (37) |
| Gross Profit | - | - | 4 | 10 |
| EBITDA | (4) | (4) | (9) | (2) |
| Other income | - | - | (1) | (0) |
| SG&A | (4) | (4) | (15) | (20) |
| EBIT | (4) | (4) | (12) | (10) |
| Interest income | 0 | 2 | 1 | 0 |
| Reported OP | (4) | (3) | (11) | (10) |
| Finance cost | (1) | (6) | (13) | (20) |
| Others | 4 | 3 | 12 | 12 |
| Profit before tax | (4) | (9) | (24) | (29) |
| Income tax | 0 | 0 | (0) | (1) |
| Net Profit | (4) | (9) | (24) | (30) |
| Profit from discontinued operations | - | - | - | - |
| Minority Interest | (0) | - | 1 | (0) |
| Net Profit to equity holders | (4) | (9) | (23) | (30) |
| Year-end shares | 500 | 500 | 500 | 500 |
| Basic EPS (US\$) | (0.05) | (0.09) | (0.23) | (0.28) |
| FD EPS (US\$) | (0.05) | (0.09) | (0.23) | (0.28) |
| BPS (US\$) | 0.873 | 0.897 | 1.002 | 1.116 |
| DPS (US\$) | - | - | - | - |

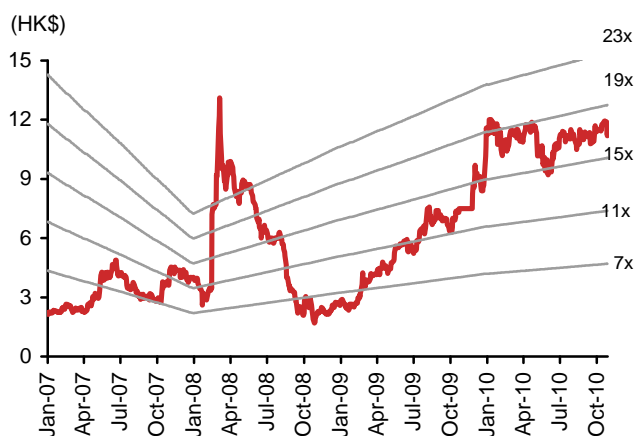
| Balance Sheet (US\$mn) | 2006A | 2007A | 2008A | 2009A |
|-------------------------------------|------------|------------|------------|------------|
| Cash and Equivalent | 19 | 54 | 13 | 39 |
| Account Receivable | 2 | 3 | 3 | 7 |
| Inventories | - | - | 2 | 2 |
| Others | - | - | - | - |
| Total current assets | 21 | 57 | 18 | 48 |
| PP&E | 0 | 0 | 72 | 68 |
| Intangible assets | 592 | 599 | 668 | 647 |
| Investment in associates and JCEs | - | - | - | - |
| Others | 0 | 28 | 1 | 1 |
| Total non-current assets | 593 | 627 | 741 | 716 |
| Total Assets | 613 | 684 | 759 | 764 |
| ST debt | - | - | 3 | 4 |
| Account Payable | 4 | 7 | 19 | 18 |
| Others | - | - | 52 | 1 |
| Total current liabilities | 4 | 7 | 75 | 22 |
| LT debt | 20 | - | - | - |
| Others | 153 | 229 | 165 | 165 |
| Total LT liabilities | 173 | 229 | 165 | 165 |
| Total Liabilities | 177 | 236 | 239 | 187 |
| Equity Capital | 0 | 0 | 0 | 0 |
| Reserves | 437 | 448 | 501 | 558 |
| Shareholder's equity | 437 | 448 | 501 | 558 |
| Minority interest | - | - | 19 | 19 |
| Total Liabilities and Equity | 613 | 684 | 759 | 764 |

| Ratio Analysis | 2006A | 2007A | 2008A | 2009A |
|-----------------------|-------|----------|----------|----------|
| ROE | -1% | -2% | -5% | -6% |
| ROA | -1% | -1% | -3% | -4% |
| ROIC | -1% | -2% | -5% | -6% |
| Net gearing | 0% | net cash | net cash | net cash |
| Debt/equity | 5% | 0% | 1% | 1% |
| Debt/capital | 5% | 0% | 1% | 1% |
| Interest coverage (X) | NA | NA | NA | NA |
| Dividend payout ratio | 0% | 0% | 0% | 0% |

Source: Company data

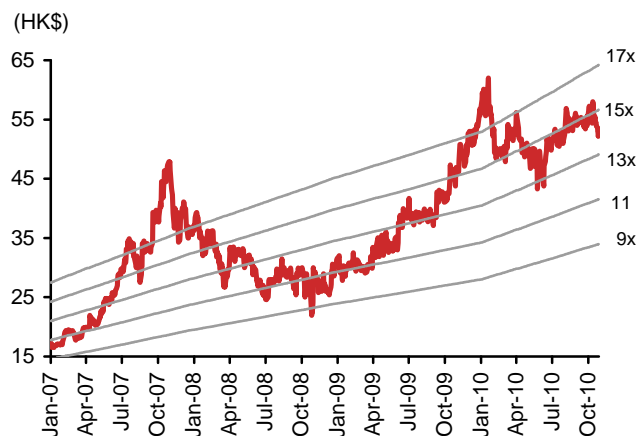
Appendix

Exhibit 87. CR Gas: Forward PE band chart



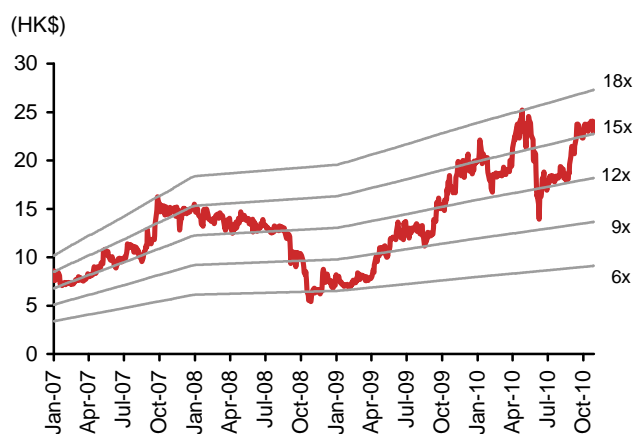
Source: Bloomberg, Nomura research

Exhibit 88. BJE: Forward PE band chart



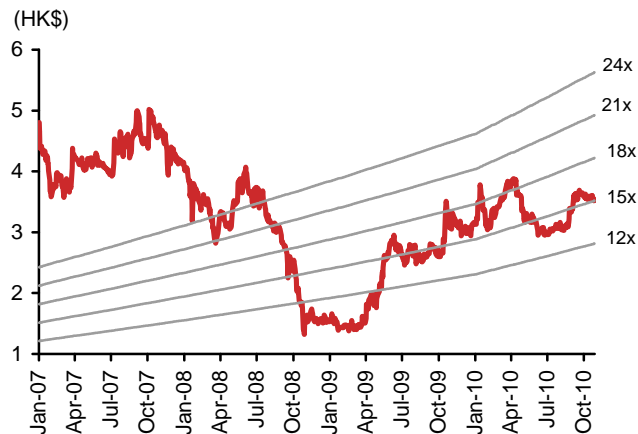
Source: Bloomberg, Nomura research

Exhibit 89. ENN Energy: Forward PE band chart



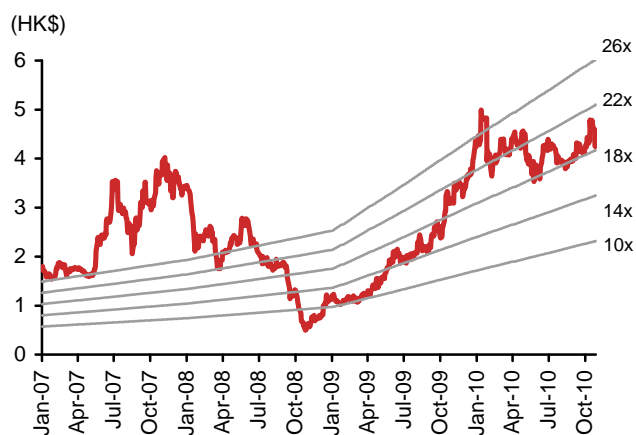
Source: Bloomberg, Nomura research

Exhibit 90. Towngas China: Forward PE band chart



Source: Bloomberg, Nomura research

Exhibit 91. China Gas: Forward PE band chart



Source: Bloomberg, Nomura research

Exhibit 92. China: Company profiles of major gas players

| <u>Company</u> | <u>Ticker</u> | <u>Rating</u> | <u>Ownership</u> | <u>Business scope</u> | <u>Comments</u> |
|------------------|---------------|---------------|------------------|---|---|
| CR Gas | 1193 HK | BUY | State-owned | NG distribution in Mainland China | Benefits from value accretive parent's asset injections & leverage on CR brand name to secure projects |
| BJE | 392 HK | BUY | State-owned | NG distribution, beer, water management and tollroad in China | Combination of two hot areas, gas and water in China |
| Kunlun Energy | 135 HK | BUY | State-owned | E&P, LNG operation and NG distribution in Mainland China | Supported by PetroChina's rich gas resources, Kunlun Energy is well positioned to capture China's robust natural gas demand growth |
| ENN Energy | 2688 HK | NEUTRAL | Private | NG distribution in Mainland China | Slow down in securing new projects, focus on organic growth and new energy business, risk profile changes |
| Towngas China | 1083 HK | NEUTRAL | Under HKCG | NG distribution in Mainland China | Unattractive parent's asset injection story |
| China Gas | 384 HK | REDUCE | Private | NG and LPG distribution in Mainland China | LPG dragging down profitability; option dilution will limit shareholders' return |
| HKCG | 3 HK | REDUCE | Private | NG distribution, water and energy operations in Hong Kong and Mainland China. | Although there is a likely upward revision on FY10F earnings, but only on one-off items, we find HKCG is unattractive on valuation. |
| Sino Gas | 260 HK | NR | Private | CNG station operation and LPG distribution in Mainland China | Management is upbeat towards next 2 years with its CNG business while issuing shares of 335mn to pay debt |
| China Oil Gas | 603 HK | NR | Private | NG and LPG distribution in Mainland China | Expanding into Jiangxi, engaging in machinery business, operating CBM in Oct |
| Pearl Oriental | 632 HK | NR | Private | Oil and gas operation in US | Large amount of fund raised was used to pay for oil projects in Utah in the US |
| Sino Oil Gas | 702 HK | NR | Private | Oil operation in US and Oil and CBM drilling in mainland China | HK\$2.34bn acquired CBM field in Shanxi and Shaanxi, and still at drilling stage with CBM segment |
| Suntien Green | 956 HK | NR | State-owned | Wind power operator and NG distribution in Mainland China | Owns >30% of the natural gas market in Hebei but majority of its IPO proceeds go to the wind segment |
| Tian Lun Gas | 1600 HK | NR | Private | NG distribution in Henan | Three projects in Henan currently, with the IPO money for CNG and piped gas network expansion in Henan |
| Zhengzhou Gas | 3928 HK | NR | State-owned | NG distribution in Mainland Zhengzhou | 56.87% of ZZG shares were held by a JV which the JV is 80% owned by CR Gas |
| Zhongyu Gas | 8070 HK | NR | Private | NG distribution and CBM drilling in Mainland China | 56% acquired by China Gas, and China Gas said it would prevent it from delisting |
| Enviro Energy | 8182 HK | NR | Private | Oil and CBM drilling in mainland China | Raise HK\$160.7mn for the Xinjiang CBM project |
| Tianjin Tianlian | 8290 HK | NR | State-owned | NG distribution in Mainland China | It has been injected as an asset by Tianjin Gas to the JV with CR Gas |
| China Energy | CEGY SP | NR | Private | Dimethyl ether manufacturing | Management's positive outlook for the DME market in the PRC |
| Green Dragon | GDG LN | NR | Private | NG distribution and CBM drilling in Mainland China | Produced a total of 5mn m3 through 1H10 with its CBM mine in Shanxi |

Source: Company data, Nomura research

Exhibit 93. Valuation methodology and risks

| Company | Ticker | Valuation methodology | Risks |
|-----------------------------|---------|--|--|
| China Resources Gas | 1193 HK | Our price target of HK\$14.8 is based on a sum-of-the-parts (SOTP) valuation, of which HK\$12.29 comes from the existing 41 projects and HK\$2.50 from to-be-injected projects. For the to-be-injected projects, we assign a 50% discount to DCF value to reflect uncertainty over the timing and consideration. | We have a positive view on the company's overall operation, but are wary of a slower-than-expected new connection and gas sales growth. Meanwhile, the value of future asset injections could be hurt by higher-than-expected investment considerations, in our view. |
| Beijing Enterprises Holding | 392 HK | Our PT of HK\$70.5 is based on a sum-of-the-parts (SOTP) valuation, which takes into account the different business nature and risk profile of BJE's investments. We divided BJE into five parts: Piped gas operation. We value the piped gas operation business using a DCF model, which assumes 0% terminal growth and a WACC of 7.6%. Brewery. We value the brewery business using the current market value of 56.48%-owned Yanjing Beer. Water treatment. We value BEW using our price target for the stock. For Beijing No. 9 and the 10 Water Treatment Plant concession, we value the assets using a DCF model, assuming 0% terminal growth and a WACC of 7.6%. Expressway & toll road. We value the toll road business using a DCF model, assuming 0% terminal growth and a WACC of 7.6%. Other. We value the other businesses using EV/EBITDA and market value approaches. | Risks to our positive view include: 1) slower-than-expected sales growth for the gas, water and brewery businesses; 2) unfavourable regulatory changes to the above three segments; and 3) value-destructive asset acquisitions. |
| ENN Energy | 2688 HK | Our price target of HK\$24.1 is based on DCF valuation, assuming 0% terminal growth, a one-year forward FX rate of HK\$1.25:RMB1 and a WACC of 8.3%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects without a specified commencement date (such as the Vietnam project). | Downside risks to our price target include: 1) slower-than-expected new connection and gas sales growth; 2) margin squeeze by cost pass-through delay. Upside risks include: 1) higher-than-expected gas volume sales to higher margin C&I and vehicle users; 2) value-constructive asset injection / acquisition. |
| Towngas China | 1083 HK | Our new price target of HK\$3.4 is based on DCF valuation, assuming 0% terminal growth, and a WACC of 6.4%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects without a specified commencement date. | Downside risks to our price target include: 1) slower-than-expected new connection and gas sales growth; 2) margin squeeze due to cost pass-through delay Upside risks include: 1) higher-than-expected gas volume sales to higher margin C&I and vehicle users; and 2) value-constructive asset injection / acquisition. |
| Kunlun Energy | 135 HK | We value Kunlun Energy at HK\$13.5, based on an FY11F ROACE of 17.7% and WACC of 7.1% with a LT growth rate of 3%. Our price target implies upside of 33.9%. | Investment risks include policy risks, uncertainty of Kunlun Gas injection and timing and profitability of natural gas earnings contribution, crude oil prices and production risks, as well as share issuance. |
| China Gas | 384 HK | Our price target of HK\$3.70 is based on DCF valuation, assuming 0% terminal growth, and a WACC of 7.6%. We do not incorporate any unapproved or unannounced development projects or future acquisitions, or any projects without specified commencement date. | Upside risks to our price target include: 1) higher-than-expected gas volume sales to higher margin C&I and vehicle users; 2) value-constructive acquisition; 3) continuous picking up for the LPG business margin and volume; and 4) possibility of being an acquisition target amid industry consolidation in the long-term. |
| Hong Kong and China Gas | 3 HK | SOTP valuation, which implies 22x FY10F P/E (3.1x book) for the Hong Kong Towngas business, 32x FY10F P/E (2.1x book) for the China business and no NAV discount for the property portfolio. | Upside risks include acquisitions of more projects in China and share buy-backs. Other risks include regulatory risks, larger-than-expected mark-to-market loss of investment securities and investment property write-down. |

Source: Nomura estimates

Sector comparison

Sector valuation I

Exhibit 94. Asia ex-Japan utilities stocks valuation summary

| | | Reporting | Share | Free | | Price target | Price | Market cap | EPS (local \$) | | | DPS (local \$) | | | Net profit (local \$ m) | | | |
|-------------------------------|------------|-----------|----------|-----------|-------|--------------|------------|------------|----------------|---------|--------|----------------|--------|--------|-------------------------|---------|--------|--------|
| Company | Type | Ticker | currency | o/s (mn) | float | Rating | Local (\$) | Local (\$) | (US\$m) | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F |
| Hongkong Electric | Integrated | 6 HK | HKD | 2134 | 61.1 | Buy | 55.10 | 49.95 | 13,753 | 3.14 | 3.35 | 3.75 | 2.11 | 2.11 | 2.22 | 6,697 | 7,154 | 7,996 |
| CLP Holdings | Integrated | 2 HK | HKD | 2406 | 78.4 | Neutral | 56.40 | 64.30 | 19,959 | 3.41 | 3.70 | 3.85 | 2.48 | 2.22 | 2.31 | 8,196 | 8,911 | 9,259 |
| Hong Kong & China Gas | Gas | 3 HK | HKD | 7,182 | 98.2 | Reduce | 16.50 | 19.02 | 17,623 | 0.79 | 0.67 | 0.74 | 0.35 | 0.40 | 0.45 | 5,175 | 4,839 | 5,295 |
| CKI | Integrated | 1038 HK | HKD | 2,254 | 15.2 | Buy | 36.60 | 33.30 | 9,684 | 2.47 | 2.08 | 2.63 | 1.20 | 1.25 | 1.58 | 5,568 | 4,699 | 5,927 |
| HK utilities average | | | | | | | | | 15,255 | 2.45 | 2.45 | 2.74 | 1.53 | 1.50 | 1.64 | 6,409 | 6,401 | 7,119 |
| Datang Intl | IPP | 991 HK | CNY | 12,480 | 33.0 | Neutral | 3.10 | 3.15 | 13,116 | 0.14 | 0.13 | 0.16 | 0.06 | 0.05 | 0.07 | 1,612 | 1,560 | 2,045 |
| Huaneng Power Intl | IPP | 902 HK | CNY | 12,055 | 44.2 | Buy | 5.30 | 4.42 | 12,080 | 0.41 | 0.25 | 0.31 | 0.23 | 0.14 | 0.17 | 4,930 | 2,975 | 3,746 |
| Huadian Power Intl | IPP | 1071 HK | CNY | 6,771 | 36.1 | Neutral | 1.80 | 1.85 | 4,211 | 0.19 | 0.11 | 0.10 | 0.06 | 0.03 | 0.03 | 1,157 | 683 | 709 |
| China Power Intl | IPP | 2380 HK | CNY | 5,084 | 44.2 | Neutral | 1.70 | 1.77 | 1,353 | 0.14 | 0.09 | 0.13 | 0.03 | 0.03 | 0.04 | 519 | 466 | 643 |
| China Resources Power | IPP | 836 HK | HKD | 4,683 | 33.6 | Buy | 18.90 | 15.04 | 9,143 | 1.20 | 0.98 | 1.17 | 0.27 | 0.23 | 0.27 | 5,317 | 4,604 | 5,466 |
| China power average | | | | | | | | | 7,981 | 0.41 | 0.31 | 0.37 | 0.13 | 0.09 | 0.12 | 2,707 | 2,058 | 2,522 |
| China Shenhua Energy | Coal | 1088 HK | CNY | 19,890 | 26.1 | Buy | 44.60 | 35.65 | 100,314 | 1.59 | 1.89 | 2.12 | 0.53 | 0.69 | 0.77 | 31,706 | 37,494 | 42,090 |
| Suntech | Solar | STP US | USD | 179 | 70.5 | Buy | 12.20 | 8.43 | 1,519 | 0.49 | 0.81 | 0.96 | - | - | - | 88 | 145 | 173 |
| Canadian Solar | Solar | CSIQ US | USD | 41 | 69.5 | Neutral | 12.20 | 13.95 | 596 | 0.51 | 1.59 | 1.67 | - | - | - | 21 | 66 | 69 |
| Trina Solar | Solar | TSL US | USD | 70 | 70.0 | Buy | 27.50 | 26.81 | 2,117 | 2.28 | 2.76 | 3.06 | - | - | - | 124 | 193 | 214 |
| Yingli Green | Solar | YGE US | USD | 148 | 63.2 | Buy | 23.00 | 11.96 | 1,775 | (2.32) | 6.94 | 7.70 | - | - | - | (266) | 1,029 | 1,143 |
| LDK Solar | Solar | LDK US | USD | 131 | 29.0 | Neutral | 8.00 | 11.52 | 1,514 | (1.71) | 0.63 | 0.69 | - | - | - | (222) | 82 | 91 |
| JA Solar | Solar | JASO US | USD | 164 | 63.2 | Buy | 8.00 | 8.47 | 1,423 | (0.12) | 0.86 | 1.04 | - | - | - | (13) | 141 | 170 |
| Solargiga | Solar | 757 HK | CNY | 1,691 | 0.0 | Reduce | 1.10 | 1.80 | 487 | 0.12 | 0.15 | 0.17 | - | - | - | 195 | 260 | 293 |
| GCL Poly | Solar | 3800 HK | HKD | 15,472 | 47.5 | Neutral | 1.30 | 2.46 | 5,699 | (0.02) | 0.14 | 0.14 | - | - | - | (176) | 2,149 | 2,102 |
| China solar average | | | | | | | | | 1,891 | (0.10) | 1.73 | 1.93 | - | - | - | (31) | 508 | 532 |
| China Everbright Intl | Water | 257 HK | HKD | 3,639 | 51.6 | Buy | 6.10 | 4.19 | 1,969 | 0.11 | 0.16 | 0.21 | 0.02 | 0.03 | 0.04 | 367 | 593 | 760 |
| Guangdong Investment | Water | 270 HK | HKD | 6,232 | 38.9 | Buy | 5.50 | 4.05 | 3,257 | 0.32 | 0.38 | 0.40 | 0.11 | 0.13 | 0.13 | 2,008 | 2,341 | 2,495 |
| China Water Affairs | Water | 855 HK | HKD | 1,328 | 82.5 | Buy | 4.10 | 3.06 | 535 | 0.02 | 0.11 | 0.15 | 0.03 | 0.05 | 0.05 | 25 | 141 | 198 |
| Beijing Enterprises Water | Water | 371 HK | HKD | 4,567 | 38.6 | Buy | 4.20 | 2.64 | 1,555 | 0.07 | 0.10 | 0.13 | - | - | - | 207 | 418 | 777 |
| Hyflux Limited | Water | HYF SP | SGD | 571 | 68.5 | Neutral | 3.50 | 3.17 | 1,407 | 0.14 | 0.14 | 0.18 | 0.03 | 0.03 | 0.04 | 75 | 77 | 101 |
| Sound Global Ltd | Water | 967HK | CNY | 1,290 | 45.6 | Buy | 7.40 | 5.27 | 1,018 | 0.22 | 0.28 | 0.40 | 0.04 | - | - | 281 | 364 | 530 |
| Tianjin Capital | Water | 1065 HK | CNY | 1,427 | 90.0 | Reduce | 2.10 | 2.74 | 1,483 | 0.17 | 0.20 | 0.16 | 0.08 | 0.10 | 0.07 | 243 | 289 | 223 |
| China water average | | | | | | | | | 1,414 | 0.15 | 0.20 | 0.23 | 0.04 | 0.05 | 0.05 | 458 | 603 | 726 |
| China Resources Gas | Gas | 1193 HK | HKD | 1,414 | 0.6 | Buy | 14.80 | 11.72 | 2,769 | 0.31 | 0.46 | 0.60 | 0.06 | 0.08 | 0.12 | 444 | 743 | 1,102 |
| Beijing Enterprises | Gas | 392 HK | HKD | 1,137 | 0.5 | Buy | 70.50 | 52.05 | 7,637 | 2.11 | 2.67 | 3.11 | 0.65 | 0.82 | 0.92 | 2,399 | 3,031 | 3,538 |
| ENN Energy | Gas | 2688 HK | CNY | 1,050 | 0.6 | Neutral | 24.10 | 25.35 | 3,986 | 0.78 | 0.97 | 1.14 | 0.19 | 0.24 | 0.28 | 801 | 1,016 | 1,195 |
| Towngas China | Gas | 1083 HK | HKD | 1,956 | 0.2 | Neutral | 3.40 | 3.56 | 1,125 | 0.14 | 0.16 | 0.19 | 0.02 | 0.03 | 0.04 | 265 | 352 | 470 |
| China Gas | Gas | 384 HK | HKD | 3,713 | 0.6 | Reduce | 3.70 | 4.42 | 2,075 | 0.03 | 0.26 | 0.19 | 0.01 | 0.01 | 0.02 | 104 | 876 | 747 |
| China gas average | | | | | | | | | 3,518 | 0.67 | 0.90 | 1.05 | 0.19 | 0.24 | 0.28 | 802 | 1,204 | 1,410 |
| China High Speed | Wind | 658 HK | CNY | 1,375 | 78.0 | Buy | 22.00 | 16.46 | 3,389 | 0.78 | 1.02 | 1.33 | 0.26 | 0.31 | 0.40 | 966 | 1,402 | 1,829 |
| China Longyuan | Wind | 916 HK | CNY | 7,464 | 71.6 | Reduce | 7.60 | 8.07 | 9,019 | 0.15 | 0.25 | 0.35 | - | - | - | 894 | 1,882 | 2,595 |
| China Yangtze Power | Hydro | 600900 CH | CNY | 11,000 | 32.3 | Buy | 11.00 | 8.43 | 20,827 | 0.58 | 0.72 | 0.73 | 0.30 | 0.42 | 0.42 | 5,690 | 7,933 | 7,978 |
| Shanghai Electric | Equipment | 2727 HK | CNY | 12,500 | 95.0 | Neutral | 3.50 | 5.31 | 19,758 | 0.20 | 0.21 | 0.20 | 0.06 | 0.05 | 0.05 | 2,453 | 2,614 | 2,536 |
| Dongfang Electric | Equipment | 1072 HK | CNY | 900 | 90.2 | Reduce | 34.50 | 40.95 | 12,700 | 1.91 | 1.94 | 2.68 | 0.02 | 0.58 | 0.80 | 1,712 | 1,750 | 2,410 |
| Harbin Power | Equipment | 1133 HK | CNY | 1376.806 | 99.8 | Reduce | 5.80 | 11.92 | 2,457 | 0.44 | 0.50 | 0.48 | 0.07 | 0.13 | 0.12 | 606 | 692 | 666 |
| China equipment average | | | | | | | | | 11,639 | 0.85 | 0.89 | 1.12 | 0.05 | 0.25 | 0.32 | 1,591 | 1,685 | 1,871 |
| Korea Electric Power | Integrated | 015760 KS | KRW | 642 | 46.0 | Buy | 43,000.00 | 29,300 | 17,126 | (197) | (399) | 1,451 | 0 | 0 | 456 | (127) | (256) | 931 |
| Korea Gas | Gas | 036460 KS | KRW | 72.608547 | 32.0 | Buy | 52,000.00 | 45,100.00 | 3,185 | 3,278 | 2,810 | 3,870 | 983.36 | 843.02 | 1,161.02 | 238.00 | 204.03 | 281.00 |
| Korea utilities average | | | | | | | | | 10,156 | 1,540 | 1,205 | 2,661 | 491.68 | 421.51 | 808.61 | 56 | (26) | 606 |
| E-Ton Solar Tech | Solar | 3452 TT | TWD | 205 | 73.3 | Reduce | 38.50 | 41.8 | 342 | (11.43) | (1.98) | 2.11 | - | - | - | (2,340) | (405) | 433 |
| Motech Industries | Solar | 6244 TT | TWD | 376 | 60.9 | Reduce | 97.00 | 123.5 | 1,541 | 0.11 | 7.17 | 7.63 | 2.00 | 2.00 | 2.00 | 33 | 2,700 | 2,874 |
| Taiwan solar average | | | | | | | | | 942 | (5.66) | 2.60 | 4.87 | 1.00 | 1.00 | 1.00 | (1,153) | 1,148 | 1,653 |
| Indonesia | | | | | | | | | | | | | | | | | | |
| Perusahaan Gas Negara | Gas | PGAS IJ | IDR | 24,242 | 43.0 | Buy | 4,300.00 | 4225.00 | 11,476 | 222.79 | 211.06 | 236.62 | 163.61 | 115.00 | 127.37 | 5,227 | 5,087 | 5,736 |
| Glow | IPP | GLOW TB | THB | 1,439 | 25.0 | Buy | 52.00 | 52.50 | 2,582 | 2.53 | 3.28 | 3.81 | 1.82 | 1.91 | 2.01 | 3,699 | 4,726 | 5,480 |
| Electricity Generating | IPP | EGCO TB | THB | 526 | 39.8 | Buy | 90.00 | 98.0 | 1,735 | 14.26 | 13.27 | 12.39 | 5.00 | 5.05 | 5.10 | 7,506 | 6,989 | 6,522 |
| Ratchaburi Generating | IPP | RATCH TB | THB | 1450 | 34.5 | Neutral | 40.00 | 36.8 | 1,792 | 4.64 | 3.97 | 3.89 | 2.25 | 2.28 | 2.32 | 6,732 | 5,759 | 5,644 |
| Thai power average | | | | | | | | | 2,036 | 7.14 | 6.84 | 6.70 | 3.02 | 3.08 | 3.14 | 5,979 | 5,824 | 5,882 |
| Malaysia | | | | | | | | | | | | | | | | | | |
| Tenaga Nasional | Integrated | TNB MK | MYR | 4,337 | 40.6 | Neutral | 9.60 | 8.79 | 12,417 | 0.50 | 0.59 | 0.64 | 0.13 | 0.25 | 0.15 | 2,157 | 2,569 | 2,796 |
| YTLP | Integrated | YTLP MK | MYR | 6,753 | 42.9 | Neutral | 2.30 | 2.34 | 5,501 | 0.11 | 0.18 | 0.19 | 0.13 | 0.11 | 0.12 | 647 | 1,126 | 1,264 |
| Malaysia utilities average | | | | | | | | | 8,959 | 0.31 | 0.39 | 0.42 | 0.13 | 0.18 | 0.13 | 1,402 | 1,848 | 2,030 |
| Philippines | | | | | | | | | | | | | | | | | | |
| Energy Development Corp | Power | EDC PM | PHP | 18,750 | 58.2 | Buy | 6.40 | 6.0 | 2,633 | 0.39 | 0.45 | 0.47 | 0.10 | 0.11 | 0.14 | 7,381 | 8,347 | 8,732 |
| Meralco | Power | MER PM | PHP | 1128 | 69.1 | Reduce | 134.10 | 221.00 | 5,831 | 2.05 | 13.33 | 16.58 | 2.50 | 4.00 | 5.80 | 2,272 | 15,028 | 18,694 |
| Philippines utilities average | | | | | | | | | 4,232 | 1.22 | 6.89 | 8.52 | 1.30 | 2.05 | 2.97 | 4,826 | 11,688 | 13,713 |
| Suzlon | WTG | SUEL IN | INR | 1557 | 35.9 | Neutral | 88.80 | 56.65 | 2,228 | 7.67 | 1.33 | 5.70 | - | - | - | 11,328 | 2,025 | 8,868 |

Note: Priced on 2 Nov 10. * Annualised.

Source: Bloomberg, Nomura International (Hong Kong) Ltd estimates

Sector valuation II

Exhibit 95. Asia ex-Japan utilities stocks valuation summary

| Company | EPS growth (%) | | | DPS growth (%) | | | Net earnings growth (%) | | | EV/MW (local \$) | | | P/E (x) | | | Yield (%) | | |
|--------------------------------------|----------------|----------------|--------------|----------------|----------------|---------------|-------------------------|-----------------|--------------|------------------|-------------|-------------|-----------------|--------------|--------------|-------------|-------------|-------------|
| | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F |
| Hongkong Electric | (16.6) | 6.8 | 11.8 | - | 0.00 | 5.00 | (16.59) | 6.83 | 11.77 | NA | NA | NA | 15.92 | 14.90 | 13.33 | 4.22 | 4.22 | 4.44 |
| CLP Holdings | (21.3) | 8.7 | 3.9 | (0.1) | (10.40) | 3.90 | (21.37) | 8.72 | 3.90 | NA | NA | NA | 18.88 | 17.36 | 16.71 | 3.85 | 3.45 | 3.59 |
| Hong Kong & China Gas | 21.9 | (14.4) | 9.4 | (0.0) | 14.28 | 12.50 | 20.28 | (6.50) | 9.43 | NA | NA | NA | 24.17 | 28.23 | 25.80 | 1.84 | 2.10 | 2.37 |
| CKI | 25.9 | (15.6) | 26.2 | 5.8 | 4.14 | 26.15 | 25.89 | (15.62) | 26.15 | NA | NA | NA | 13.48 | 15.98 | 12.66 | 3.61 | 3.76 | 4.74 |
| HK utilities average | 2.5 | (3.6) | 12.8 | 1.4 | 2.01 | 11.89 | 2.05 | (1.64) | 12.81 | NA | NA | NA | 18.11 | 19.12 | 17.13 | 3.38 | 3.38 | 3.78 |
| Datang Intl | 111.2 | (3.7) | 24.3 | 111.8 | (8.65) | 31.07 | 111.77 | (3.22) | 31.07 | 6.34 | 5.74 | 5.55 | 20.53 | 22.47 | 17.15 | 2.01 | 1.84 | 2.41 |
| Huaneng Power Intl | NA | (39.7) | 25.9 | 127.3 | (39.66) | 25.94 | NA | (39.66) | 25.94 | 3.64 | 3.35 | 3.12 | 9.64 | 15.98 | 12.69 | 5.77 | 3.48 | 4.38 |
| Huadian Power Intl | NA | (44.5) | (1.8) | NA | (47.55) | 3.91 | NA | (41.02) | 3.91 | 2.58 | 1.90 | 1.56 | 8.59 | 16.37 | 15.76 | 3.63 | 1.91 | 1.98 |
| China Power Intl | NA | (34.1) | 37.9 | NA | (10.13) | 37.93 | NA | (10.13) | 37.93 | 2.20 | 1.81 | 1.71 | 15.47 | 17.21 | 12.48 | 1.94 | 1.74 | 2.40 |
| China Resources Power | 189.5 | (17.8) | 18.7 | 9.5 | (17.77) | 18.71 | 209.61 | (13.41) | 18.71 | 5.95 | 5.47 | 4.98 | 13.25 | 15.30 | 12.89 | 1.83 | 1.50 | 1.78 |
| China power average | 150.3 | (27.9) | 21.0 | 82.9 | (24.75) | 23.51 | 160.69 | (21.49) | 23.51 | 4.14 | 3.66 | 3.38 | 13.49 | 17.47 | 14.19 | 3.04 | 2.09 | 2.59 |
| China Shenhua Energy | 19.0 | 18.3 | 12.3 | 15.2 | 29.37 | 12.31 | 19.01 | 18.26 | 12.26 | NA | NA | NA | 19.58 | 16.04 | 13.39 | 1.70 | 2.27 | 2.72 |
| Suntech | (62.4) | 65.5 | 18.9 | NA | NA | NA | (56.26) | 65.48 | 18.89 | NA | NA | NA | 17.52 | 10.59 | 8.91 | 0.00 | 0.00 | 0.00 |
| Canadian Solar | (26.2) | 210.5 | 4.8 | NA | NA | NA | (3.29) | 210.55 | 4.79 | NA | NA | NA | 27.94 | 9.00 | 8.59 | 0.00 | 0.00 | 0.00 |
| Trina Solar | 41.5 | 21.1 | 11.2 | NA | NA | NA | 54.11 | 55.38 | 11.21 | NA | NA | NA | 13.54 | 10.93 | 9.83 | 0.00 | 0.00 | 0.00 |
| Yingli Green | (144.3) | NA | 11.0 | NA | NA | NA | (139.84) | NA | 11.03 | NA | NA | NA | NA | 11.69 | 10.29 | 0.00 | 0.00 | 0.00 |
| LDK Solar | (354.9) | NA | 10.6 | NA | NA | NA | (415.60) | NA | 10.63 | NA | NA | NA | NA | 18.39 | 16.62 | 0.00 | 0.00 | 0.00 |
| JA Solar | (129.3) | NA | 21.4 | NA | NA | NA | (119.12) | NA | 20.25 | NA | NA | NA | NA | 9.85 | 8.11 | 0.00 | 0.00 | 0.00 |
| Solargiga | (30.8) | 33.6 | 12.6 | NA | NA | NA | (28.15) | 33.59 | 12.62 | NA | NA | NA | 13.01 | 9.74 | 8.65 | 0.00 | 0.00 | 0.00 |
| GCL Poly | (103.9) | NA | (2.2) | NA | NA | NA | (109.15) | NA | (2.19) | NA | NA | NA | NA | 14.94 | 14.92 | 0.00 | 0.00 | 0.00 |
| China solar average | (101.3) | 82.7 | 11.0 | NA | NA | NA | (102.16) | 91.25 | 10.90 | NA | NA | NA | 18.00 | 11.89 | 10.74 | - | - | - |
| China Everbright Intl | 18.5 | 50.6 | 28.1 | 29.2 | 59.47 | 28.09 | 28.05 | 61.58 | 28.09 | NA | NA | NA | 39.33 | 25.90 | 20.07 | 0.49 | 0.79 | 1.01 |
| Guangdong Investment | (0.1) | 15.9 | 6.2 | 10.0 | 14.18 | 6.20 | 0.81 | 16.59 | 6.57 | NA | NA | NA | 12.72 | 10.91 | 10.24 | 2.72 | 3.10 | 3.29 |
| China Water Affairs | (42.7) | 441.8 | 33.9 | NA | 67.04 | 5.00 | (43.22) | 461.26 | 40.33 | NA | NA | NA | 146.98 | 28.81 | 21.93 | 0.98 | 1.64 | 1.72 |
| Beijing Enterprises Water | 38.0 | 57.8 | 23.4 | NA | NA | NA | 436.38 | 101.39 | 86.09 | NA | NA | NA | 37.48 | 25.44 | 20.61 | 0.00 | 0.00 | 0.00 |
| Hyflux Limited | 26.8 | (2.3) | 26.9 | 80.8 | (13.47) | 49.78 | 27.10 | 1.99 | 31.81 | NA | NA | NA | 22.62 | 23.22 | 18.72 | 1.08 | 0.93 | 1.39 |
| Sound Global Ltd | 32.7 | 29.7 | 40.5 | 4.1 | (100.00) | NA | 37.75 | 29.70 | 45.69 | NA | NA | NA | 21.27 | 16.40 | 11.67 | 0.79 | 0.00 | 0.00 |
| Tianjin Capital | 5.2 | 19.1 | (23.0) | 100.0 | 19.14 | (23.05) | 5.16 | 19.14 | (23.05) | NA | NA | NA | 14.49 | 12.16 | 15.80 | 3.24 | 3.87 | 2.97 |
| China water average | 11.2 | 87.5 | 19.4 | 44.8 | 7.73 | 13.21 | 70.29 | 98.81 | 30.79 | NA | NA | NA | 42.13 | 20.41 | 17.01 | 1.33 | 1.47 | 1.48 |
| China Resources Gas | (49.6) | 46.0 | 31.4 | NA | NA | NA | 0.49 | 0.68 | 0.48 | NA | NA | NA | 37.37 | 25.59 | 19.48 | 0.55 | 0.73 | 1.08 |
| Beijing Enterprises | 5.2 | 26.3 | 16.8 | 0.0 | 0.3 | 0.1 | 0.05 | 0.26 | 0.17 | NA | NA | NA | 24.67 | 19.53 | 16.73 | 1.16 | 1.58 | 1.85 |
| ENN Energy | 24.4 | 24.5 | 17.6 | 0.2 | 0.3 | 0.2 | 0.27 | 0.27 | 0.18 | NA | NA | NA | 29.64 | 22.69 | 18.43 | 0.84 | 1.10 | 1.36 |
| Towngas China | 31.0 | 18.2 | 20.2 | 1.0 | 0.4 | 0.3 | 0.31 | 0.33 | 0.33 | NA | NA | NA | 26.29 | 22.25 | 18.51 | 0.64 | 0.81 | 1.09 |
| China Gas | (29.2) | 741.9 | (26.0) | 0.0 | 0.2 | 0.2 | (0.26) | 7.45 | (0.15) | NA | NA | NA | 142.10 | 16.88 | 22.82 | 0.99 | 0.32 | 0.38 |
| China gas average | (3.6) | 171.4 | 12.0 | 0.3 | 0.28 | 0.21 | 0.17 | 1.80 | 0.20 | NA | NA | NA | 52.01 | 21.39 | 19.19 | 0.84 | 0.91 | 1.15 |
| China High Speed | 39.6 | 31.3 | 30.5 | 20.0 | 15.83 | 30.47 | 39.57 | 45.04 | 30.47 | NA | NA | NA | 18.56 | 14.43 | 10.81 | 1.84 | 2.21 | 2.94 |
| China Longyuan | 119.1 | 70.5 | 37.9 | NA | NA | NA | 165.00 | 110.48 | 37.89 | NA | NA | NA | 47.49 | 27.48 | 19.33 | 0.00 | 0.00 | 0.00 |
| China Yangtze Power | 38.9 | 24.3 | 0.6 | 40.2 | 39.43 | 0.57 | 44.76 | 39.43 | 0.57 | NA | NA | NA | 16.30 | 11.69 | 11.62 | 3.59 | 5.00 | 5.03 |
| Shanghai Electric | (8.7) | 6.6 | (3.0) | (8.0) | (11.09) | (2.99) | (4.40) | 6.54 | (2.99) | NA | NA | NA | 23.60 | 22.14 | 22.82 | 1.27 | 1.13 | 1.10 |
| Dongfang Electric | 244.1 | 1.8 | 37.7 | (91.7) | 2863.62 | 37.68 | 275.11 | 2.22 | 37.68 | NA | NA | NA | 18.69 | 18.36 | 13.33 | 0.06 | 1.63 | 2.25 |
| Harbin Power | (41.8) | 14.2 | (3.8) | (9.4) | 84.91 | (3.76) | (41.82) | 14.20 | (3.76) | NA | NA | NA | 23.60 | 20.67 | 21.47 | 0.65 | 1.21 | 1.16 |
| China equipment average | 64.5 | 7.5 | 10.3 | (36.4) | 979.15 | 10.31 | 76.30 | 7.65 | 10.31 | NA | NA | NA | 21.96 | 20.39 | 19.21 | 0.66 | 1.32 | 1.50 |
| Korea Electric Power | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | 20.69 | 0.00 | 0.00 | 1.56 |
| Korea Gas | (28.1) | (14.3) | 37.7 | (16.0) | (14.27) | 37.72 | (28.06) | (14.27) | 37.72 | NA | NA | NA | 13.76 | 16.05 | 11.65 | 2.18 | 1.87 | 2.57 |
| Korea utilities average | (28.1) | (14.3) | 37.7 | (16.0) | (14.27) | 37.72 | (28.06) | (14.27) | 37.72 | NA | NA | NA | 13.76 | 16.05 | 16 | 1 | 1 | 2.07 |
| E-Ton Solar Tech | (196.6) | NA | NA | (100.0) | NA | NA | (292.84) | NA | NA | NA | NA | NA | NA | NA | 19.78 | 0.00 | 0.00 | 0.00 |
| Motech Industries | (98.8) | 6,407.7 | 6.4 | (33.4) | 0.00 | 0.00 | (98.55) | 8,035.47 | 6.44 | NA | NA | NA | 1,120.59 | 17.22 | 16.18 | 1.62 | 1.62 | 1.62 |
| Taiwan solar average | (147.7) | 6,407.7 | 6.4 | (66.7) | 0.00 | 0.00 | (195.69) | 8,035.47 | 6.44 | NA | NA | NA | 1,120.59 | 17.22 | 17.98 | 0.81 | 0.81 | 0.81 |
| Indonesia | | | | | | | | | | | | | | | | | | |
| Perusahaan Gas Negara | 102.3 | (5.3) | 12.1 | 1,085.5 | (29.71) | 10.76 | 106.82 | (2.69) | 12.77 | NA | NA | NA | 19.58 | 20.12 | 17.84 | 3.87 | 2.72 | 3.01 |
| Glow | (2.3) | 29.9 | 16.0 | 5.0 | 5.00 | 5.00 | (2.28) | 27.76 | 15.95 | NA | NA | NA | 20.78 | 15.99 | 13.79 | 3.47 | 3.65 | 3.83 |
| Electricity Generating | 0.2 | (6.9) | (6.7) | - | 1.00 | 1.00 | 0.21 | (6.90) | (6.68) | NA | NA | NA | 6.87 | 7.38 | 7.91 | 5.10 | 5.15 | 5.20 |
| Ratchaburi Generating | 3.2 | (14.5) | (2.0) | 1.8 | 1.50 | 1.50 | 3.20 | (14.46) | (1.99) | NA | NA | NA | 7.92 | 9.25 | 9.44 | 6.12 | 6.21 | 6.31 |
| Thai power average | 0.4 | 2.9 | 2.4 | 2.3 | 2.50 | 2.50 | 0.38 | 2.13 | 2.43 | NA | NA | NA | 11.86 | 10.87 | 10.38 | 4.90 | 5.00 | 5.11 |
| Malaysia | | | | | | | | | | | | | | | | | | |
| Tenaga Nasional | (15.8) | 19.0 | 8.8 | (10.7) | 84.99 | (37.68) | (15.73) | 19.10 | 8.83 | NA | NA | NA | 17.67 | 14.84 | 13.64 | 1.51 | 2.80 | 1.74 |
| YTL | (43.2) | 56.7 | 5.2 | 15.0 | (11.17) | 1.50 | (37.76) | 74.21 | 12.23 | NA | NA | NA | 28.46 | 16.28 | 14.74 | 5.53 | 4.91 | 4.98 |
| Malaysia utilities average | (15.5) | 27.4 | 1.3 | 1.4 | 28.3 | (12.0) | (13.62) | 33.30 | 3.65 | NA | NA | NA | 20.07 | 14.78 | 14.36 | 3.72 | 4.10 | 3.77 |
| Philippines | | | | | | | | | | | | | | | | | | |
| Energy Development Corp | 26.2 | 13.1 | 4.6 | (64.7) | 11.63 | 25.53 | 26.49 | 13.10 | 4.61 | NA | NA | NA | 15.24 | 13.48 | 12.88 | 1.66 | 1.85 | 2.33 |
| Meralco | (19.2) | 549.9 | 24.4 | 40.8 | 59.87 | 45.12 | (18.86) | 561.45 | 24.39 | NA | NA | NA | 107.78 | 16.58 | 13.33 | 1.13 | 1.81 | 2.63 |
| Philippines utilities average | 3.51 | 281.51 | 14.50 | -11.96 | 35.75 | 35.32 | 3.82 | 287.27 | 14.50 | NA | NA | NA | 61.51 | 15.03 | 13.11 | 1.40 | 1.83 | 2.48 |
| Suzlon | (15.6) | (82.7) | 329.6 | (100.0) | NA | NA | (13.88) | (82.12) | 337.87 | NA | NA | NA | 7.77 | 45.09 | 10.30 | 0.00 | 0.00 | 0.00 |

Note: Priced on 2 Nov 10. * Annualised.

Source: Bloomberg, Nomura International (Hong Kong) Ltd estimates

Sector valuation III

Exhibit 96. Asia ex-Japan utilities stocks valuation summary

| | Dividend payout (%) | | | BV/share (local \$) | | | P/B (x) | | | EV/EBITDA (x) | | | EBITDA Margin (%) | | | RoIC (%) | | | RoE (%) | | | RoA (%) | | |
|---------------------------|---------------------|-------|-------|---------------------|-------|-------|---------|------|------|---------------|-------|-------|-------------------|-------|-------|----------|--------|-------|---------|-------|-------|---------|--------|-------|
| Company | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F | 09 | 10F | 11F |
| Hongkong Electric | 67.25 | 62.95 | 59.14 | 24.43 | 25.68 | 27.21 | 2.04 | 1.95 | 1.84 | 12.74 | 13.54 | 11.81 | 71.20 | 70.41 | 70.01 | 10.45 | 9.65 | 9.83 | 13.47 | 13.38 | 14.17 | 9.34 | 8.73 | 8.98 |
| CLP Holdings | 72.74 | 59.95 | 59.95 | 29.38 | 30.77 | 32.34 | 2.19 | 2.09 | 1.99 | 10.68 | 10.72 | 10.04 | 29.66 | 27.71 | 26.48 | 8.16 | 8.21 | 8.18 | 12.27 | 12.31 | 12.18 | 5.66 | 5.61 | 5.59 |
| Hong Kong & China Gas | 44.49 | 59.38 | 61.04 | 5.03 | 4.92 | 5.27 | 3.78 | 3.86 | 3.61 | 19.82 | 18.55 | 17.42 | 38.03 | 38.36 | 37.17 | 10.76 | 9.58 | 10.32 | 16.30 | 14.19 | 14.46 | 7.29 | 7.76 | 8.06 |
| CKI | 48.62 | 60.00 | 60.00 | 18.73 | 19.56 | 20.61 | 1.78 | 1.70 | 1.62 | 18.30 | 18.52 | 14.32 | 7.78 | 22.62 | 25.73 | 11.42 | 8.73 | 9.91 | 14.12 | 10.89 | 13.09 | 11.51 | 8.36 | 9.54 |
| HK utilities average | 58.27 | 60.57 | 60.03 | 19.39 | 20.23 | 21.36 | 2.45 | 2.40 | 2.26 | 15.38 | 15.33 | 13.40 | 36.67 | 39.78 | 39.85 | 10.20 | 9.04 | 9.56 | 14.04 | 12.69 | 13.48 | 8.82 | 7.50 | 7.97 |
| Datang Intl | 41.34 | 39.21 | 41.34 | 2.22 | 2.23 | 2.32 | 1.26 | 1.26 | 1.21 | 11.34 | 17.10 | 13.16 | 29.73 | 22.55 | 26.25 | 1.37 | 1.02 | 1.15 | 6.18 | 5.78 | 7.20 | 0.94 | 0.77 | 0.89 |
| Huaneng Power Intl | 55.60 | 55.60 | 55.60 | 3.49 | 3.60 | 3.74 | 1.13 | 1.09 | 1.05 | 9.30 | 10.86 | 10.08 | 23.13 | 17.79 | 17.22 | 4.09 | 2.26 | 2.74 | 12.49 | 6.95 | 8.46 | 2.71 | 1.47 | 1.79 |
| Huadian Power Intl | 31.19 | 29.46 | 31.19 | 2.67 | 2.45 | 2.52 | 0.62 | 0.67 | 0.66 | 8.92 | 10.06 | 9.71 | 23.02 | 21.34 | 22.00 | 1.95 | 1.02 | 0.91 | 8.41 | 4.18 | 4.22 | 1.24 | 0.62 | 0.56 |
| China Power Intl | 22.00 | 30.00 | 30.00 | 2.45 | 2.51 | 2.60 | 0.65 | 0.63 | 0.61 | 17.27 | 6.15 | 5.63 | 19.81 | 28.32 | 28.76 | 1.64 | 1.30 | 1.99 | 5.06 | 3.70 | 4.95 | 1.35 | 0.98 | 1.47 |
| China Resources Power | 23.00 | 23.00 | 23.00 | 8.03 | 8.78 | 9.68 | 1.87 | 1.71 | 1.55 | 10.10 | 7.07 | 5.94 | 30.96 | 32.05 | 31.92 | 7.56 | 6.00 | 6.73 | 16.41 | 11.70 | 12.64 | 5.36 | 3.77 | 4.22 |
| China power average | 34.63 | 35.46 | 36.23 | 3.77 | 3.91 | 4.17 | 1.11 | 1.07 | 1.02 | 11.38 | 10.25 | 8.90 | 25.33 | 24.41 | 25.23 | 3.32 | 2.32 | 2.70 | 9.71 | 6.46 | 7.49 | 2.32 | 1.52 | 1.79 |
| China Shenhua Energy | 33.25 | 36.37 | 36.39 | 8.58 | 9.82 | 11.25 | 3.64 | 2.98 | 2.44 | 10.81 | 8.83 | 7.44 | 48.13 | 49.09 | 48.76 | 13.32 | 14.04 | 13.94 | 19.94 | 20.49 | 20.09 | 10.80 | 11.44 | 11.60 |
| Suntech | 0.00 | - | - | 8.93 | 7.71 | 8.68 | 0.94 | 1.09 | 0.97 | 9.71 | 8.25 | 6.95 | 14.20 | 13.56 | 14.44 | 3.84 | (3.31) | 7.40 | 2.20 | 3.70 | NA | 2.38 | (1.85) | 4.59 |
| Canadian Solar | 0.00 | - | - | 11.27 | 12.26 | 13.93 | 1.24 | 1.14 | 1.00 | 15.04 | 7.03 | 6.46 | 6.62 | 8.73 | 8.27 | 4.42 | 7.15 | 10.63 | 5.87 | 8.41 | 12.73 | 2.91 | 3.31 | 4.40 |
| Trina Solar | 0.00 | - | - | 12.43 | 14.98 | 18.07 | 2.16 | 1.79 | 1.48 | 9.84 | 4.92 | 5.05 | 22.25 | 23.52 | 21.02 | 8.91 | 13.08 | 12.56 | 17.58 | 22.34 | 18.54 | 7.84 | 10.91 | 10.10 |
| Yingli Green | 0.00 | - | - | 53.69 | 48.41 | 56.12 | 1.49 | 1.58 | 1.36 | 15.79 | 5.89 | 5.18 | 13.49 | 24.75 | 24.92 | (3.01) | 9.46 | 9.12 | (4.87) | 15.44 | 14.74 | (2.06) | 6.64 | 6.86 |
| LDK Solar | 0.00 | - | - | 6.84 | 7.38 | 8.07 | 1.68 | 1.56 | 1.43 | NA | 13.28 | 13.88 | (14.77) | 13.31 | 13.39 | (13.80) | 4.20 | 5.01 | (26.64) | 8.86 | 8.97 | (5.71) | 1.79 | 1.90 |
| JA Solar | 0.00 | - | - | 6.00 | 5.07 | 6.17 | 1.41 | 1.67 | 1.37 | 34.60 | 6.71 | 4.81 | 7.16 | 18.00 | 16.23 | (1.31) | 11.32 | 19.04 | (1.91) | 18.57 | 18.54 | (1.23) | 11.45 | 11.51 |
| Solargiga | 0.00 | - | - | 0.89 | 1.05 | 1.22 | 1.63 | 1.39 | 1.19 | 6.11 | 5.07 | 4.00 | 17.09 | 18.18 | 17.75 | 10.86 | 12.57 | 24.73 | 13.79 | 15.86 | 15.29 | 10.29 | 11.56 | 11.11 |
| GCL Poly | 0.00 | - | - | 0.91 | 0.80 | 0.94 | 2.32 | 2.52 | 2.16 | 25.72 | 9.76 | 9.87 | 31.54 | 24.25 | 23.28 | (1.26) | 12.65 | 18.70 | (3.75) | 19.02 | 15.66 | (1.10) | 8.29 | 7.57 |
| China solar average | - | - | - | 12.62 | 12.21 | 14.15 | 1.61 | 1.59 | 1.37 | 16.69 | 7.61 | 7.03 | 12.20 | 18.04 | 17.41 | 1.08 | 8.39 | 13.40 | 0.28 | 14.02 | 14.92 | 1.66 | 6.51 | 7.26 |
| China Everbright Intl | 19.09 | 20.21 | 20.21 | 1.26 | 1.39 | 1.56 | 3.33 | 3.01 | 2.69 | 23.53 | 17.76 | 14.52 | 39.25 | 31.56 | 31.84 | 5.27 | 7.41 | 8.14 | 10.06 | 12.31 | 14.16 | 4.97 | 6.52 | 7.29 |
| Guangdong Investment | 33.90 | 33.39 | 33.38 | 2.74 | 2.99 | 3.26 | 1.48 | 1.35 | 1.24 | 6.98 | 6.28 | 5.53 | 68.58 | 70.45 | 71.97 | 7.96 | 9.25 | 9.28 | 12.61 | 13.13 | 12.80 | 6.59 | 7.37 | 7.39 |
| China Water Affairs | 146.06 | 45.03 | 35.30 | 1.55 | 1.92 | 1.99 | 1.97 | 1.59 | 1.54 | 27.42 | 13.53 | 9.08 | 16.27 | 31.12 | 39.67 | 3.46 | 7.57 | 4.35 | 6.33 | 13.63 | 7.63 | 2.31 | 4.53 | 2.51 |
| Beijing Enterprises Water | 0.00 | - | - | 0.75 | 0.79 | 0.96 | 3.50 | 3.33 | 2.76 | 28.39 | 18.91 | 10.51 | 23.17 | 9.14 | 13.79 | 3.93 | 4.93 | 5.53 | 8.80 | 13.37 | 14.29 | 3.15 | 4.53 | 4.75 |
| Hyflux Limited | 23.92 | 21.19 | 25.00 | 0.69 | 0.58 | 0.68 | 4.59 | 5.45 | 4.65 | 16.28 | 14.95 | 13.00 | 21.84 | 20.15 | 20.12 | 11.91 | 8.90 | 8.90 | 24.01 | 23.43 | 29.79 | 7.82 | 6.12 | 6.39 |
| Sound Global Ltd | 16.88 | - | - | 1.20 | 1.48 | 2.08 | 3.86 | 3.13 | 2.22 | 14.89 | 10.28 | 6.27 | 25.36 | 21.98 | 21.86 | 16.25 | 12.82 | 12.97 | 19.64 | 21.07 | 22.14 | 11.71 | 11.07 | 11.68 |
| Tianjin Capital | 46.99 | 46.99 | 46.99 | 2.31 | 2.42 | 2.50 | 1.07 | 1.02 | 0.99 | 8.65 | 7.33 | 9.46 | 57.39 | 51.67 | 43.33 | 4.17 | 5.12 | 4.11 | 7.59 | 8.59 | 6.35 | 3.29 | 4.24 | 3.48 |
| China water average | 40.98 | 23.83 | 22.98 | 1.50 | 1.65 | 1.86 | 2.83 | 2.70 | 2.30 | 18.02 | 12.72 | 9.77 | 35.98 | 33.72 | 34.66 | 7.57 | 8.00 | 7.61 | 12.72 | 15.08 | 15.31 | 5.69 | 6.34 | 6.21 |
| China Resources Gas | 19.13 | 20.00 | 20.00 | 0.73 | 3.33 | 3.81 | 16.07 | 3.52 | 3.07 | 28.04 | 13.69 | 9.03 | 20.71 | 19.33 | 20.37 | 21.41 | 18.61 | 22.33 | 27.21 | 20.85 | 16.85 | 6.77 | 6.16 | 6.50 |
| Beijing Enterprises | 30.82 | 30.82 | 30.82 | 27.52 | 29.48 | 32.22 | 1.89 | 1.77 | 1.62 | 11.41 | 10.03 | 8.58 | 17.51 | 16.73 | 15.09 | 5.92 | 6.82 | 7.36 | 7.87 | 9.35 | 9.86 | 4.33 | 4.91 | 5.26 |
| ENN Energy | 25.00 | 25.00 | 25.00 | 4.92 | 5.64 | 6.49 | 4.54 | 3.83 | 3.13 | 12.45 | 10.59 | 8.09 | 23.65 | 19.84 | 18.13 | 8.30 | 9.64 | 10.99 | 17.00 | 18.34 | 18.75 | 5.13 | 5.63 | 5.61 |
| Towngas China | 14.77 | 20.00 | 20.00 | 3.29 | 3.45 | 3.61 | 1.08 | 1.03 | 0.99 | 15.73 | 12.15 | 9.83 | 22.61 | 20.90 | 19.37 | 3.05 | 3.29 | 4.26 | 3.84 | 4.45 | 5.12 | 2.44 | 2.85 | 3.42 |
| China Gas | 38.58 | 5.33 | 9.72 | 0.97 | 1.23 | 1.83 | 4.57 | 3.60 | 2.41 | 22.82 | 15.62 | 10.09 | 16.67 | 17.13 | 14.46 | 0.85 | 5.97 | 5.07 | 3.26 | 23.84 | 12.35 | 0.71 | 4.27 | 3.10 |
| China gas average | 25.66 | 20.23 | 21.11 | 7.48 | 8.63 | 9.59 | 5.63 | 2.75 | 2.24 | 18.09 | 12.42 | 9.12 | 20.23 | 18.78 | 17.48 | 7.90 | 8.87 | 10.00 | 11.84 | 15.36 | 12.58 | 3.88 | 4.76 | 4.78 |
| China High Speed | 34.01 | 30.00 | 30.00 | 3.55 | 5.46 | 6.48 | 3.98 | 2.47 | 2.08 | 14.82 | 9.71 | 8.09 | 27.45 | 24.38 | 24.51 | 12.63 | 13.36 | 14.81 | 23.71 | 23.51 | 22.28 | 10.33 | 10.44 | 10.65 |
| China Longyuan | 0.00 | - | - | 3.62 | 3.19 | 3.53 | 1.91 | 2.17 | 1.86 | 17.44 | 14.39 | 11.83 | 39.77 | 42.58 | 53.75 | 2.26 | 4.25 | 4.27 | 6.94 | 8.24 | 10.35 | 1.72 | 2.61 | 2.90 |
| China Yangtze Power | 52.17 | 58.50 | 58.50 | 5.46 | 5.76 | 6.06 | 1.54 | 1.46 | 1.39 | 16.52 | 8.44 | 8.45 | 87.05 | 88.65 | 89.04 | 5.17 | 5.40 | 5.39 | 11.66 | 12.86 | 12.27 | 5.19 | 4.96 | 4.94 |
| Shanghai Electric | 29.98 | 25.00 | 25.00 | 1.80 | 2.01 | 2.21 | 2.58 | 2.31 | 2.09 | 36.89 | 32.16 | 27.71 | 4.85 | 5.55 | 6.15 | 9.73 | 9.39 | 8.23 | 11.17 | 10.99 | 9.62 | 2.86 | 2.75 | 2.40 |
| Dongfang Electric | 1.03 | 30.00 | 30.00 | 9.69 | 11.59 | 14.27 | 3.68 | 3.08 | 2.50 | 13.02 | 11.70 | 8.46 | 6.01 | 6.70 | 7.51 | 16.74 | 14.29 | 16.16 | 31.63 | 18.31 | 20.70 | 2.58 | 2.38 | 3.26 |
| Harbin Power | 15.44 | 25.00 | 25.00 | 6.27 | 6.78 | 7.26 | 1.66 | 1.53 | 1.43 | 4.10 | 3.00 | 2.43 | 3.40 | 4.00 | 4.09 | 5.01 | 5.55 | 5.02 | 7.23 | 7.71 | 6.89 | 1.19 | 1.30 | 1.24 |
| China equipment average | 15.48 | 26.67 | 26.67 | 5.92 | 6.79 | 7.91 | 2.64 | 2.31 | 2.01 | | | | | | | | | | | | | | | |

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We, Ivan Lee, Joseph Lam and Christian Jiang, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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On August 2, 2010, Hyflux Ltd. ("Hyflux") and Mitsui & Co., Ltd. ("Mitsui") announced the signing of a joint venture agreement to develop water projects in China. A newly formed 50:50 joint venture company, Galaxy NewSpring Pte. Ltd. ("JV Company") will serve as the partners' vehicle for investing, developing, and managing projects in China's water sector. The JV Company will acquire four water treatment plants from Hyflux's subsidiary Spring China Utility Ltd. for US\$53.1 million. The JV Company has also submitted a delisting proposal for Hyflux Water Trust ("HWT") and intends to make an exit offer to acquire all of the HWT units not controlled by the JV Company, Hyflux, Mitsui, Hyflux Asset Management Pte. Ltd., Hyflux Water Projects Ltd or the trustee-manager of HWT (collectively the "JV Parties") for S\$0.78/unit. The Offer is subject to 1) the approval of a delisting resolution by HWT's unitholders, and 2) the JV Company receiving valid acceptances in respect of such number of units that, when taken together with the units owned, controlled or agreed to be acquired by the JV Parties, will comprise not less than 75% of the total voting rights of HWT at the close of the exit offer.

Nomura acted as financial adviser to Mitsui in connection with the joint venture and for both Hyflux and Mitsui in connection with the delisting proposal and exit offer.

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As at 30 September 2010.

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Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America for ratings published from 27 October 2008

The rating system is a relative system indicating expected performance against a specific benchmark identified for each individual stock. Analysts may also indicate absolute upside to price target defined as (fair value - current price)/current price, subject to limited management discretion. In most cases, the fair value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as discounted cash flow or multiple analysis, etc.

STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.

A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.

A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.

A rating of '**RS-Rating Suspended**', indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.

Benchmarks are as follows: **United States/Europe**: Please see valuation methodologies for explanations of relevant benchmarks for stocks (accessible through the left hand side of the Nomura Disclosure web page: <http://www.nomura.com/research>); **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology.

SECTORS

A '**Bullish**' stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months.

A '**Neutral**' stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.

A '**Bearish**' stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.

Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Price Target - Current Price) / Current Price, subject to limited management discretion. In most cases, the Price Target will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.

A '**Buy**' recommendation indicates that potential upside is 15% or more.

A '**Neutral**' recommendation indicates that potential upside is less than 15% or downside is less than 5%.

A '**Reduce**' recommendation indicates that potential downside is 5% or more.

A rating of '**RS**' or '**Rating Suspended**' indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company.

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SECTORS

A '**Bullish**' rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.

A '**Neutral**' rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.

A '**Bearish**' rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008)

STOCKS

A rating of '**1**' or '**Strong buy**', indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.

A rating of '**2**' or '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.

A rating of '**3**' or '**Neutral**', indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.

A rating of '**4**' or '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.

A rating of '**5**' or '**Sell**', indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.

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SECTORS

A '**Bullish**' stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.

A '**Neutral**' stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.

A '**Bearish**' stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Japan**: TOPIX; **United States**: S&P 500, MSCI World Technology Hardware & Equipment; **Europe**, by sector - *Hardware/Semiconductors*: FTSE W Europe IT Hardware; *Telecoms*: FTSE W Europe Business Services; *Business Services*: FTSE W Europe; *Auto & Components*: FTSE W Europe Auto & Parts; *Communications equipment*: FTSE W Europe IT Hardware; **Ecology Focus**: Bloomberg World Energy Alternate Sources; **Global Emerging Markets**: MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

A **'Strong buy'** recommendation indicates that upside is more than 20%.

A **'Buy'** recommendation indicates that upside is between 10% and 20%.

A **'Neutral'** recommendation indicates that upside or downside is less than 10%.

A **'Reduce'** recommendation indicates that downside is between 10% and 20%.

A **'Sell'** recommendation indicates that downside is more than 20%.

SECTORS

A **'Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.

A **'Neutral'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.

A **'Bearish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Price targets

Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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